SURFACE TRANSPORTATION BOARD

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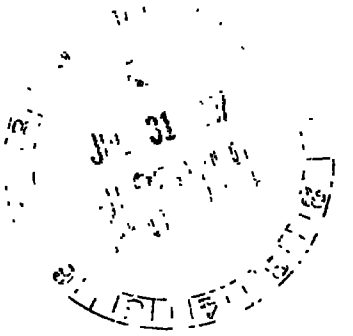

JULY 18, 2007

Held at 9:00 a.m. Ground Floor Conference Room, Richard Bolling Federal Building, 601 East 12th Street, Kansas City, Missouri

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A p p e a r a n c e s:

Board Members:

Vice Chairman W. Douglas Buttrey

Commissioner Francis P. Mulvey

VICE CHAIRMAN BUTTREY: Good morning everyone. I appreciate your attendance here today. To begin this morning, I have to tell you that it has fallen on my lot to deliver some sad news. Chip Nottingham's brother, I think older brother, unexpectedly passed away last night. He has been called back to Washington, D.C. to administer to his family and parents and so forth, under the circumstances. That sort of casts somewhat of a dark pall over our day today, certainly for the STB staff and the other members. We send our condolences to the family and wish them well. We will be trying to support them however we can over the next few days and weeks.

We appreciate your attendance here today. I am going to read for the record the Chairman's opening statement. The opening statement of Chairman Nottingham. Kansas City hearing, July 18, 2007. I am going to read this into the record as if he were here and then I will have just very brief remarks. I'm sure Commissioner Mulvey will have remarks as well, and he will deliver those at the appropriate moment. So we will read Chairman Nottingham's statement into the record as if he were here for the record.

Good morning. It is wonderful to be here in Kansas City today to conduct a hearing on the transportation of energy resources critical to our nation's energy supply. A field hearing is not something we do every day, but we thought it was a good idea to get out of Washington, D.C. and give people closer to the commodities at issue a chance to tell us what their concerns are.

We recognize that transportation provides a vital link to the nation's energy supply chain, and that the movement of coal as well as emerging commodities such as ethanol and other biofuels is essential to the reliability of our energy supply. I hope this hearing is just the beginning of the dialogue.

In a decision issued yesterday, the Board announced that it is proceeding with the creation of a new advisory committee called the Rail Energy Transportation Advisory Committee. As many of you are aware, on March 9, the Board issued a decision announcing its proposal to form this committee in seeking public comment. The Board received comments from energy producers, rail carriers, trade associations and other interested parties. Having taken those comments

into consideration, and after consultation with the General Services Administration, the Board has decided to establish the new committee and has developed a charter to govern the Committee's operation. We have hard copies of yesterday's decision with the Committee's charter attached available here. I think on the desk over here. And also can be downloaded from the Board's website.

For the new committee we have created a balanced membership that we believe is representative of the interested affected parties. As the decision explains, the Committee will consist of not less than five representatives from the Class 1 railroads, three representatives from Class 2 and Class 3 railroads, three representatives from coal producers, five representatives from electric utilities. Including at least one rural electric cooperative and one state or municipally owned utility. Four representatives from biofuel refiners, processors or distributors, or biofuel feedstock growers or providers. And two representatives from the private car owners, car lessors or car manufacturers. The Committee may also include up

to three members, not necessarily affiliated with one of the industries or sectors making up the core members.

The three STB members will be non-voting ex officio members of the committee. And we may also invite representatives from the U.S. Departments of Agriculture, Energy and Transportation and the Federal Energy Regulatory Commission to serve as ex officio members as well.

I anticipate that the first meeting of the Committee will be in the fall of this year. I and my fellow board members look forward to your suggestions for membership on the committee. Those suggestions should be submitted by August 9, 2007. That is August 9, 2007.

Now before we begin, let me take just a few minutes to review a few procedural points about today's hearing. We will hear from panels with breaks as appropriate. We will hear from all the speakers on the panel. We have already read your comments, so please summarize them here. For the speakers, Secretary Williams will be keeping track of your time allotment. You will hear a soft electronic beep when your time has expired. Please do your best to keep to the time that you

have been allotted.

After the hearing from the entire panel, we will rotate the questions from each board member until we have exhausted the questions. Consistent with board practice, we will allow all the witnesses on each panel to make full presentations before the members ask any questions.

Finally, just a reminder to everyone to turn off your cell phones. I certainly look forward to a very interesting day of testimony. With that I will recognize Vice Chairman Buttrey for any opening statement he may have.

For the record, that concludes the reading of Chairman Nottingham's opening statement. And we provide that for the record as if he were here.

In terms of my own opening statement, I would just say this: I am here to listen. I am not here to speak. I will ask some questions. I would say that my major concern is the balancing of the interests of all the shippers in the country.

It concerns me from time to time that certain segments of the rail traffic might be

getting more service than other equally viable parts of the shipper community. That is something that I certainly intend to keep a very close eye on. I doubt seriously if we have any grain shippers here today. I have taken a great interest in grain. I am going to be watching to see if grain shippers are suffering service levels, because service has been allotted in an unbalanced way to other segments of the shipping community. That is something that concerns me very much.

I have observed over my short tenure here on the Board that every shipper believes that his commodity is the most important one to the entire world. I think that is universally true throughout the shipping community. I know it is certainly true of coal, and I know it is certainly true of grain. And I'm sure that there are other commodities represented here today that feel exactly the same way.

Having said that, expressed what my primary concerns are and interests are, I will turn the floor over to Commissioner Mulvey for any statement that he might have, and then we will, even under these circumstances, we will proceed

with the people's business. Thank you very much.

COMMISSIONER MULVEY: Thank you Vice Chairman Buttrey. Let me join you in expressing my condolences and sending my regards and best wishes to Chairman Nottingham and his family at this hour of their need. It was quite a shock to all of us.

I would like to say also good morning and welcome to our panelists and other attendees. The issues surrounding the reliability of energy resources are an important subset of those we considered earlier this year when we held a hearing in Washington D.C. on rail capacity and infrastructure. They also overlap the broader question of the current scope of railroad's common carrier obligations, a topic I hope, and I know Chairman Nottingham feels the same way, that we will be able to explore in more depth in the near future.

Obviously ensuring that coal, ethanol, biofuels and other energy resources are transported safely, securely, efficiently and promptly is critical to the health of our nation's economy. The United States is the world's largest consumer of the planet's energy resources, and is

a major generator, unfortunately we are no longer number one in this category, but is still a major generator of greenhouse gases.

If we are able to -- if we are to continue to be the world's largest economy while simultaneously adopting policies that protect the global environment, we must have a modern transportation infrastructure that can address all of those needs. I expect that the railroads will continue to be alert to shifts in government policy and market based changes that would affect their need to invest in the transportation infrastructure.

I hope that today's hearings will highlight the importance of transportation to the energy supply network, and as always I am eager to hear from today's witnesses and to engage in a dialogue with them. Thank you very much.

VICE CHAIRMAN BUTTREY: Thank you, Commissioner Mulvey. I would like to call the first panel. Freight Railroads, BNSF Railway, Kevin D. Kauffman and Stevan Bobb. I understand Mr. Bobb could not be here today. So I call up Mr. Kauffman to the witness stand. Thank you, sir, for being with us today. I failed to mention

that we have Jack Koraleski here, who is a witness in this panel as well. Please come forward. Thank you for being with us today.

MR. KAUFMAN: Vice Chairman Buttrey, Commissioner Mulvey. Thank you for the opportunity to speak. We have just a few slides. We are going to basically just go over a few things. One, an ethanol overview of where BNSF is. What our tranportation -- what we have done with ethanol to date, how we are dealing with it. Then the last part is what we really think is the issue that should be brought to your attention, that may impact the logistical supply chain in the future.

Basically if you look at the -- I don't know how I am going to communicate these slides. If you look -- if you basically look at ethanol volume, it is a wonderful story. For the last ten years, I mean, we have gone from zero to basically grown almost 20 percent to 35,000 units. Just keep that in perspective. Next slide.

If you look at it just from our total ag franchise, you will see that those 35,000 units is just a little tiny piece of what our total ag franchise is, which is approaching a million units

a year. Next slide.

Then if you look at it versus a total BNSF, I am happy to report that we have grown over 50 percent in the last ten years. But as you can see, most of that growth has been in consumer products and coal. You will see that agriculture has grown very appropriately at 18 percent. But you can see from just the size of the pie pieces, that ethanol as a part of the total units on the railroad is a very, very small piece of the railroad. Next slide.

If you look at then how it is distributed, you will notice that of course everybody knows all the ethanol plants are mostly located in the heartland of the U.S. around the corn areas. The thing that should be compelling, of course, is that ethanol is being produced where the people aren't or where the demand for the ethanol is. And the other compelling thing that people should focus on immediately is, where is that ethanol going to go and what kind of destination infrastructure is available to receive it. Next slide.

So what you basically see is the way that the ethanol is probably going to move, it is

going to move to the population centers in the southeast and the west. In fact, there is some development, but as we will see shortly, there is not a -- the growth on the demand side has not at all matched the growth on the production side. In fact, for the next year and a half we expect to see a lot more ethanol produced than there will be in the logistical capability on the demand side to receive it. Next slide.

Now what we have been doing, over five years ago we pioneered the whole idea of moving ethanol efficiently. Gathers ethanol in the heartland of the United States, puts it on a 100 car train and basically ships it to Lomeda, California; Wadson, California, this was in partnership with Shell, with an energy company, and since that time Kinder Morgan. Of course they developed the infrastructure to receive it, so it was a really nice network.

We continue to ship this ethanol express. We ship 450 trains. Basically we do it every three days to Los Angeles. But today it is the only, it is the only place that is doing. That.

VICE CHAIRMAN BUTTREY: 452 cars?

MR. KAUFMAN: No 450 trains to date. In other words, 450 hundred cars trains to date successfully differed since 2003. The most important thing is, we have never been late, we have never run them out of ethanol for their blending purposes. It is very consistent, it is very predictable, it is very, very good. Next slide. Next slide.

And the benefits from this is just when you have this kind of efficiency, when you are cycling trains as opposed to single cars, you get a lot more predictability from the logistical supply chain. We already know that. Next slide.

In addition, the railroad -- and I'm sure Jack is going to talk about the same thing -- there has been tremendous velocity improvements in the last year on the railroad. Where basically the railroads are becoming more efficient and we are able to handle a lot more units. Next slide.

In audition, we have invested heavily on the transcontinental route, which originally was for, of course, the consumer products business, but in reality, most of the ethanol is going to flow on the Transcon. So basically we have 51 miles left on the Transcon, and we are going to

finish that out by 2008. Next slide.

You can look at our locomotive and expansion capital history, and you can see most of that expansion capital has gone to either coal, the Transcon or to locomotive increases, which again, ethanol, everything is benefiting from it, but particularly ethanol is, because basically most of the corn for ethanol and the ethanol itself is going to flow in the Transcon. Next slide. I am going to skip this next slide too because it is redundant.

The real issues that we are concerned about is the fact that the destination development way lags production. It is currently being developed, but everybody should understand, this is an immature business. It has been a business that has been motivated by public policy. So some economic signals have been distorted. But basically we have a huge, huge bubble of production coming on in the next year. And frankly, there is not the destination infrastructure to efficiently receive it.

We continue to develop unit train capable destination infrastructure. I believe Jack will talk about the same thing, because we

know that that is the most efficient way to handle it. It is the cheapest way to handle it for the producers.

The other big issue that most people don't get, is the fact that -- and this is normal in an immature business. Is that the logistical supply chain management is very fragmented. Let me give you an example. The financing behind these plants have very strict covenants in that financing. And part of that strict covenants is risk management that they require for these plants. The problem is, they require risk management on the inbound corn, they demand risk management on the ethanol, they demand risk management on the DDG's. The people that manage those three areas are not necessarily in the same place, and they don't necessarily talk to each other.

So we run into issues today, for instance, where there is a very good ethanol client that is on our railroad that has accumulated large sums of demurrage, simply because they can't coordinate the inbound corn at the same time the outbound ethanol, because the people who are managing the logistical supply

chain don't talk to each other. There are consolidators involved and a lot of other things.

This is normal for an immature business. This is all going to get worked out. I mean the business will evolve reasonably efficiently. The way it is going to happen is ethanol prices are probably going to get a lot cheaper than they are today, and what that is going to do, is it is going to induce people to spend money on destination infrastructure. And they are going to have a huge incentive, when their margins begin to shrink, to be more proactive in being better managing their logistical supply chain. In the interim you are going to see lots of distortions that go on.

Now, we are particularly concerned about on our railroad that those distortions involve people adding inventory onto our tracks that needs to be stored. The old story that, We don't know where it is going to go, so we will just release it on your tracks and you can store it for us. Well, the problem with that, of course, is it gets in the way. Since most of this is in the middle of the coal route or other places, we can't afford to have these things sitting in the middle of the

railroad. So we are going to be very active in working hard with our suppliers and our customers to work on how do we better manage this logistical supply chain.

Now we are in the process of developing new destinations. I'm sure Jack will tell you the same thing. But in the interim, we think you are going to see issues and we're going to work through them. But fundamentally the GAO study is incorrect. This is not about rail capacity. There is plenty of rail capacity to haul ethanol and plenty of rail capacity to haul corn for ethanol. The real issue is just managing efficiently the logistical supply chain. And again, give you an example, you've got some plants that have over ordered cars, because they don't quite understand exactly what the efficiencies of moving those cars are, and so you've got empty brand new tank cars sitting around on places, either renting tracks or -- and industry tracks tend to be in an immature business not to be insufficient to carry the total need, for instance.

And when you are running a processing plant, there is a tremendous incentive to get

those loaded cars off your tracks so that you can load more stuff, because you never want to shut down your plant. Unfortunately, you need to have a consistent destination to go to. And so that is going to limit the efficiency of moving the network.

Again, I wanted to bring these things to your attention. We are working very closely with our customers to try and work through this thing. It is not about railroad capacity. Ethanol, we are going to grow from 35,000 cars to 70,000 cars by next year. 70,000 cars out of a million cars in total ag, there is a whole lot more additional corn that is going to be moving this year, because of the size of the crop, in exponential terms than it is about moving ethanol. So I hope some of these comments were helpful.

VICE CHAIRMAN BUTTREY: Mr. Koraleski.

MR. KORALESKI: Good morning Vice Chairman Buttrey, Commissioner Mulvey. I would also like to express the condolences of the Union Pacific family for Chairman Nottingham and his family in this time of need.

I appreciate the opportunity to be here today to discuss how Union Pacific is working to

meet the needs of the energy supply chain. We recognize that we play a critical role in meeting the nation's energy needs. Our franchise combines coverage of the key coal and agriculture producing areas of the United States with access to the fastest growing population centers in the United States. While coal and ethanol are vital to the country's economic health, they are also key components of our business strategy.

If you look, for instance, at our coal business, that was three billion dollars of business. It is roughly 20 percent of our total 15 billion dollars of business. While ethanol is a far smaller market than coal for us today, it is our fastest growing line of business. First half of 2007 our ethanol business is up almost 40 percent over last year. So it is not only important to our customers, we understand that, but it is also critically important to the success of our company.

Now to prepare ourselves to handle this growth efficiently and effectively, we have hired over 14,000 train and engine crews. We made significant investments in locomotives. We are improving the efficiency of our operations and

gaining greater additional capacity through things like our Unified Plan and our lean management applications throughout our entire network. Our customers are working with us to improve the loading and unloading of their facilities, and technology is helping us to reduce dwell time and improve velocity as well. Last, but certainly not least, we are also investing a significant amount of capital to keep this growth flowing.

Union Pacific has invested 20 billion dollars in our network since 2000, and nearly 30 billion since we completed our Southern Pacific merger back in 1996. Our 2007 Capital Plan is 3.2 billion dollars, which is the largest in our history. I think it is probably the largest anywhere in the U.S. rail industry.

As you all know, railroads are very capital intensive. You know, the average U.S. manufacturer reinvests 3.4 percent of their revenue. In 2006, our capital expenditures were actually 18 percent of our total revenue. So it is a fairly substantial number.

So with that background, let me focus just a little bit on our coal business. At any one point in time, you will find 400 coal trains

moving back and forth over the Union Pacific network. Those 400 trains last year delivered over 260 million tons of coal to customers throughout the United States. The majority of that business originates in the Southern Powder River Basin. 17 percent of it in Colorado Utah.

Growth over the next several years is going to come not only from our existing customers, but also from new plants that are being developed on Union Pacific territory. If you looked at the map, it would show you that the majority of our existing customers are located in the middle United States, but we have some new opportunities with plants in Nevada and southern Utah that are going to give us our first opportunity, our first significant opportunity to move Southern Powder River Basin coal to the west. We are pretty excited about that.

We also think the opportunities are there to move even more coal to the east, but that is really going to depend on the price of and the availability of eastern coal and then also the import/export markets that also serve those customers.

Our coal business has grown dramatically

since 1997. Our SPRB tonnage has increased 73 percent. And one of the enablers of that growth has been a fairly intense focus on productivity. Increasing the train size, using distributed power, incenting our customers to invest in high capacity aluminum cars has all resulted in a 19 percent increase in tons per train out of the Powder River Basin, and a 12 percent increase out of Colorado Utah.

Our trains per day out of the SPRB increased 46 percent, while Colorado Utah has increased 16 percent. And of course, helping to drive that improvement is nearly eight billion dollars of capital investment since the S.P. merger. That has all been directed towards our coal franchise.

Our 3.2 billion dollar 2007 Capital Plan, of that amount about one billion dollars is focused on our primary coal lines and our network. The map kind of shows you some of those key corridor improvements. Unfortunately, it is going to be a little hard to read. We are working with the BNSF on 43 miles of new triple track on the north end of the joint line. In addition to that, 31 miles of a new fourth mainline over Logan Hill.

The importance of those investments is they really start to make major step forward in terms of the projected 490 million tons of coal that should be moving out of the Southern Powder River Basin by 2010. So we were investing today to be able to handle the business three, four years out.

We have added a third main track to our North Platte facility and expanded our bail yard in the joint line, so that we can increase the fluid capacity of the railroad. We are in our final year of centralized traffic control signal systems across Iowa. So by the end of this year we should have double track CTC from the mines all the way to Chicago. And then there are a variety of sidings, passing tracks and bridge work that we are doing that is all focused on expanding capacity for our coal network.

It is important to note that we have continued to make these substantial investments, even though a significant portion of our existing base of business moves under legacy contracts. And those contracts today would not justify this kind of capital investment. Even so, we are very much committed to making the investments for a safe, reliable and efficient delivery system for

our coal customers on the belief that when it comes time to expire those contracts, we will be able to take prices up to market, continuing to have productivity improvements that will drive that business towards reinvesting and justify these kinds of investments.

Railroads are only one link in this coal supply chain. Meeting the nation's need for coal depends not only on the rails, but also on the mines and on the utilities. Coal supply chains is very tight, and today a hiccup anywhere in the supply chain usually means a missed opportunity for us. Over the past couple years all of us have had difficulties dealing with weather, operational problems and those kinds of issues.

Just yesterday, nine out of the ten mines that we serve in the Powder River Basin notified us that they were experiencing production problems that would limit the amount of trains we could load. Today seven of those nine told us that those problems are persisting today. And even though when you consider all that, the stockpiles today are about 28 percent higher than they were a year ago. Union Pacific's year to date basis has been able to deliver 93 percent of

demand as reflected in the NCTA forecast process. We are prepared to handle more. Right now the mines are just having a difficult time mining some of the coal.

Recognizing that we are just one link in the supply chain, we are working with mines, we are working with our customers. We talked in the comments about our Flip Program, where we set up alternative loading sites. In the case of an unplanned mine outage, the customers have agreed to allow us to load the train someplace else. That helps. It goes without saying, we are working with the BNSF to optimize the utilization of the joint line. We are working with the mines and the customers, encouraging them to put in the capacity and the track structure that they need from their perspective to see this business continue to grow.

So we are absolutely committed to the safe and efficient transportation of coal, and we believe that improving processes used to manage the coal supply today and eliminating those episodic outages is going to allow us to move a lot more coal more efficiently than we do today.

Let me touch briefly on ethanol and

other biofuels. We are equally committed to supporting the nation's development in the use of biofuels. We currently serve 50 production facilities throughout the upper midwest. Ethanol production capacity at the U.P. has increased certainly more dramatically than what the experts had predicted. Trippling since 2003. Future production capacity is expected to nearly double over the next couple of years. We have 35 plants today that are either on the drawing boards or in construction just on Union Pacific alone.

Just like coal, we are working with shippers and receivers to maximize the efficiency of the ethanol market. We developed our Phoenix ethanol terminal exchange program, a great example. That program actually benefits non-ethanol customers as well as the ethanol customers, because it clears up congestion. We are looking now to try to replicate that on the origin side of the business.

We are working closely with customers to ensure that the new ethanol facilities have the appropriate infrastructure necessary to ensure service at their facility without jeopardizing service to our existing customers, by tying up

mainlines, using them for switching and those kinds of things.

We recognize the most efficient way to move ethanol today is in unit trains. By 2008 we expect that about 40 percent of our business will be moving in unit trains. And we are making the investments not only on the origin side, from terminals and track structure, but also on the destination side. We have highlighted a couple of examples in our comments. The Dallas/Fort Worth two million dollar facility, and the five million up in Selby, California. We think those are all critically important, as Kevin pointed out, to the destination side.

We recognize as an emerging market there is some risk associated with this. You don't know how long the government will continue to subside ethanol. You don't know what the price of corn will do overall to the market demand. So with those kind of features. And what other kind of biofuels could emerge as an alternative. We think those risks are relatively minor compared to the demand and need today to move ethanol efficiently to the marketplace. So we are going to continue to invest.

In light of the need for continued investment to support coal, ethanol and other energy resources, and we are very concerned about the near constant drumbeat that exists today for reregulation of the railroads. Proposed bills currently in the House and the Senate threaten rail service in a variety of ways, but the bottom line is, a reduction in railroad revenues is going to triple the progress that the industry is making towards achieving reinvestability and being able to keep up the kind of capital expenditures you are seeing today.

Our Board has been willing to commit additional growth capital, with the expectation that eventually market rates will provide an adequate return. The quickest way to choke off capital investment is going to be to reregulate the railroads. Deregulation has resulted improved safety, tremendous productivity gains and at the same time helped the railroads move towards financial sustainability. We believe that the end result of reregulation is going to dry up capital. When capital dries up, then capacity will go with it over the longer term. It means customers will have to end up shifting to a higher cost operation

over the long-term.

We are making substantial investments in our infrastructure to create additional capacity to keep up with demand in both of these markets, and we are doing so as long as the investments will justify the returns. And we will continue to do so. Thank you.

VICE CHAIRMAN BUTTREY: Thank you very much. I am turn to Commissioner Mulvey for any questions he might have.

COMMISSIONER MULVEY: Thank you very much. Jack, you mentioned the problems at some of the mines in the Powder River Basin and that several of the mines were having continuing problems today. Could you be a little more specific as to what those problems are and how they affect your delivery to deliver to your customers.

MR. KORALESKI: Sure. Again, I am just trying to point out that it is a supply chain issue. We have kind of been through an event right now where after a lot of flooding and track structure repairs, the railroads are back up and running, but now the mines are experiencing problems. They were experiencing problems with

machinery, belt. One of them has a difficult time finding the right parts. A couple of the mines are dealing with a lot of the fact that the ground itself has become saturated. Typically it is a very dry environment. So as they move the overburden, it continues to seep back in, because it is heavy and wet and those kinds of things. So there are a variety of issues that the mines are dealing with right now, not the least of which is weather.

COMMISSIONER MULVEY: You mentioned that you meet 93 percent of our contracts. But a seven percent shortfall, especially in an area like coal for electricity, and also given the distribution, it is not seven percent across the board, but it is worse in some places than others. And also I note that some of the utilities have increased their stockpiles. We were out yesterday visiting with Kansas City Power & Light, and they told us they are more than doubling and trippling what they are holding in stockpiles today. Could you roughly guess what percent of that shortfall is responsible today to the mines versus the problems railroads may continue to have in their own operations.

MR. KORALESKI: For the first six months of this year we have had about 600 missed train opportunities because of the mines. We have had somewhere in the neighborhood of 350 or so as a result of Union Pacific for a variety of reasons, and then there are some smaller misses as well.

COMMISSIONER MULVEY: Kevin, would you agree that is about the same ratio for you too?

MR. KAUFMAN: For this year by far it was mine issues, flooding, that affected the delivery of coal. And of course inventories are building up. Inventories are building up simply because the weather has been -- it has been cooler, or it has been warmer in the wintertime.

COMMISSIONER MULVEY: One of the things that has concerned me about ethanol and the rail carriage of ethanol is that the flows, commodity flows would be different from the historic flows of corn to export markets of corn to other end users. While there is some capacity in the system right now, matrix seem to indicate that dwell times are down, velocity is up and the like.

If the economy begins to recover and we begin to have growth again and we begin to put the system in more and more capacity, how does the

change in the commodity flows, moving all of these ethanol unit trains in directions and in routes different than what is typical, affect the overall capacity of the system? I mean, it takes a long time to truly increase capacity. As this ethanol market grows, as it is predicted, wouldn't that put a real strain on the overall efficiency of the railroad network?

MR. KAUFMAN: First of all, the perspective. Even if ethanol grows to the extent that people say it might grow in the future, you are talking about increasing it to 100,000 units a year, 125,000 units a year. It is less than one half of one percent of the railroad's total units. And so while it is incremental business and it is welcome incremental business, it is also business that is going to flow on probably the most efficient part of the railroad. And so really, we don't see ethanol having any real significant impact on our capacity. We just don't think it is an issue.

COMMISSIONER MULVEY: Jack, do you agree?

MR. KORALESKI: You know, pretty much. We have invested, or will invest by the end of

this year about 108 million dollars in capital on ethanol, and we will run maybe $180 million worth of revenue. So we are investing ahead of it.

We view it a little differently, in that for ethanol you have three things. You have people, you have cattle and you have grain. And those three commodities, those three issues are the same for us in producing food, feed grains, moving corn. So we don't really see the ethanol moving to different locations very much. We are kind of moving to the same locations. It is new facilities, and we want to be smart about making sure that those facilities locate in the right place and have the right infrastructure. So I don't see that as being a problem.

And the places where we are investing is in the origination sites, so that we can -- not everybody is going to ship in unit trains. We are trying to do sweep trains, so we can bring smaller loads together and create a unit train. The destination side. I think it is going to be fine. I don't see it as a major problem for us.

COMMISSIONER MULVEY: Do you have minimum train sizes you like for ethanol right now? Obviously 110 car unit trains would be

preferable. But is there any de minimis that you would want to require shippers to have?

MR. KORALESKI: No, we will move -- we will work with our customers in terms of car loads as well as a unit train. Car loads can be more expensive because of the infrastructure required, the local infrastructure and the terminal infrastructure required. The 80 car, 100 car unit trains are much more effective.

COMMISSIONER MULVEY: Are you generally asking new producers, however, to supply enough capacity to store the cars until you hook them up? Especially if they are on the mainline.

MR. KORALESKI: What we are asking our customers to do is to reflect in their investment decision, when you build a $200 million ethanol plant, to make sure that you have the rail structure -- again, it depends on where you locate.

We have some customers who unfortunately would like to locate on our triple track mainline that runs up to 180 trains a day. For a customer to locate there, we are asking them to put in power switches on both ends and enough track capacity so that they can exit that mainline at 40

miles an hour, stop the train, do their switching without interfering with the other business. If you move to less populated segments of our railroad, branch lines or even the short lines, the infrastructure requirements become much less. That is really more important to us today. We always work with customers in terms of their investment in rail cars. We don't want them to over-invest. We don't want to overpopulate our yards. That has not been a problem for us with ethanol.

COMMISSIONER MULVEY: One last question for this round. Have any of the ethanol producers expressed sticker shock when you have said that this is what is needed for us to serve you?

MR. KORALESKI: By all means. We have had some very energetic and enthusiastic discussions about that.

COMMISSIONER MULVEY: Nicely put.

MR. KORALESKI: We work hard at that issue.

VICE CHAIRMAN BUTTREY: Thank you, Commissioner. To what extent -- this is a question for both of you. To what extent are the short lines going to be involved in some of these

pulls to the mainline from these facilities? Or is it -- are most of these just locating very close to the mainline track where you can stop and pick them up and move them on?

MR. KAUFMAN: That is the investor's choice. Some investors have chosen to locate on the short lines. They make an eyes open decision on whether that particular scenario fits better than at another location. There are places where it does fit. Most of our ethanol clients are located on our mainline or our main branches, but there are clients on short lines.

VICE CHAIRMAN BUTTREY: A very small percentage are involving short line operations?

MR. KAUFMAN: You know, Doug, I couldn't tell you exactly. There aren't very many ethanol --

VICE CHAIRMAN BUTTREY: But there is some involvement with the short line railroads in these pulls?

MR. KAUFMAN: Right.

VICE CHAIRMAN BUTTREY: What about you?

MR. KORALESKI: There is a small number that are short line today. As we work with our customers and as they understand the

infrastructure requirements, that tends to have people now thinking more and more about the opportunity. We view our short line partners as an extension of our network. So certainly locating on a short line is very agreeable to us, and we are more than willing to work with the customers and the short lines to see that kind of economic development take place for our short lines.

VICE CHAIRMAN BUTTREY: You speak about having capacity on the system. Are you including in that capacity power capacity and labor capacity on all these, coal and biofuels?

MR. KAUFMAN: Yes.

VICE CHAIRMAN BUTTREY: So that is an all-encompassing term?

MR. KAUFMAN: Yes.

VICE CHAIRMAN BUTTREY: That is not just time on the track?

MR. KAUFMAN: Absolutely.

VICE CHAIRMAN BUTTREY: I presume all these tank cars that are used for ethanol are privately owned?

MR. KAUFMAN: Correct.

VICE CHAIRMAN BUTTREY: Cars. None of

those are all owned by the railroads? It is leased or owned by the producer?

MR. KAUFMAN: Correct.

VICE CHAIRMAN BUTTREY: There was some information in the written testimony about the use of what would otherwise be called hazardous materials in the process of producing power, and maybe some hazardous materials involved in the production of the biofuels themselves, and a concern about the ability to get those hazardous materials over the system and into the facilities to be used for scrubbing and other similar activities.

What is going on with respect to, with respect to the future of the railroads being willing to carry this hazardous materials into these power plants and so forth, to assist in the scrubbing process and cleaning process of the by-products?

MR. KAUFMAN: You are talking about like anhydrous ammonia going into power plants to scrub the stacks?

VICE CHAIRMAN BUTTREY: Yes. I know there is a huge amount of activity going on in this area in Washington right now about how do you

handle this. If I were a board member on a railroad, and I am spending much time thinking about my fiduciary obligations to the Board, to the company, I would be very concerned about betting the company on every movement of every train that goes out of the facility carrying a hazardous materials car. I am afraid that is sort of where we are at the present time. Someone may be able to convince me otherwise.

If I were a board member, I would be very concerned about my company carrying this material without the proper insurance requirements and protections against the unlikely event that something really bad would happen on one of those cars. I'm sure that is something that is uppermost in your minds as well.

MR. KORALESKI: You are absolutely correct. That is a very major concern for us. We think about it in terms of safety and security, and we can do a lot for safety, but -- we have had the opportunity to show customers now, with the videocameras in the front of our locomotives, what happens when a truck pulls in front of our train and those kinds of things. By the grace of God it happens to be a manifest train without chlorine or

without anhydrous ammonia. But in some other circumstance that could be disasterous and it could be a risk to the company kind of event.

That's why we are so intent on trying to work cooperatively with the manufacturers of those kinds of products to get some sort of liability cap of protection, so that -- we have no choice but to move them. We actually think we are probably the safest mode to move them. So that is probably the right decision for America. The question just is, one accident and you can take out an entire company. We are hoping to make progress.

VICE CHAIRMAN BUTTREY: The information we got on the record here, on the written record anyway, indicates that this is a major concern for the power companies, who have to have these products to be able to meet the scrubbing requirements as required by about three or four other federal agencies.

I am just curious about whether there seems to be the right appropriate level of cooperation between the power companies with the railroads in getting some type of federal response to this issue. Because it seems to me to be one

of the most critical ones facing the entire industry right now, is the movement of these hazardous materials. How do you properly insure against the loss that could occur in the horrible event that something really bad would happen?

Is the level of -- are you getting cooperation -- I may be putting you on the spot here too much to ask you to comment on that. But it seems to me that this is not just a problem for the railroads, this is a problem for the entire energy supply chain. If the EPA and these other environmental groups are going to require these kind of cleansing processes for these power plants, I think you have just got to be kind of nutty to think that coal is not going to be a part of our energy future for a very, very long time.

I mean, does there seem to be the level of cooperation out there from the energy producing sector to get this problem solved? Anything you might be able to say would help us with that. Get something on the record with that.

MR. KORALESKI: We will go anywhere to talk to anyone about helping to join forces with us in dealing with this issue. To date the progress has been very slow and we wish it would

be faster.

VICE CHAIRMAN BUTTREY: For us, if the power companies are real serious about how serious a problem it is, they will get a lot more involved. I am not intensely involved in that process, because I am not part of the environmental process. I am not part of the legislative process. I guess that is a blessing and a curse in any given day. In any case, it seems to me that if the problem is as serious as some people say it is, that there would be a much higher level of involvement in trying to get some kind of solution to this.

As I said, on any given day you are sort of betting the farm. Somebody said betting the rent in their statement. I think you are betting the farm. Having grown up on a farm, that is a big deal. To carry these materials without the proper safeguards, liability safeguards.

MR. KORALESKI: I would think that anyone who uses it, anyone who produces it, and anyone who transports it should all be together on the same page. Unfortunately at this point in time that unity does not exist.

COMMISSIONER MULVEY: To get back to the

issue of Hazmat to some extent. Ethanol itself qualifies as a Hazmat because it is flammable. It is not a TIH. There are rules I guess now which restrict how long Hazmat commodities can remain on a siding.

What is your reaction to that and how are you going to address that? It seems to me that we have problems in the system right now from production to distribution along the supply chain, and that these cars are going to have to be stored for much longer than the FRA and TSA seem to be willing to allow. How are we going to address that in the short run and the long run?

MR. KAUFMAN: Part of the issue always is trying to have the appropriate incentives in place so that people aren't going to just leave them on the railroad, in other words, to pass the risk to us to carry the product. The other part of course is working closely with your customers and your end users in order to have a sufficient logistical supply chain to avoid it.

In the in between, there is no question that in the short term there is going to just be a lot of just plain nuts and bolts work that is going to be going on to ensure that this stuff

doesn't sit on the railroad and that the producers have the appropriate sales made on their books so that it can move efficiently to a destination. Because once it either goes in a merchandise network or it gets into a unit train, it is fairly predictable how long it is going to go. The issue is going to be to align a producer with a destination, to make sure they are compatible. We are going to have to work with the both of them to make sure that we are not caught in between.

COMMISSIONER MULVEY: Do you think there is a need for a waiver in that rule for the time being, until the system becomes more efficient or some sort of mitigation, that you guarantee some level of guard security in these areas until the system is up and running and is more efficient than it is today?

MR. KAUFMAN: I think the issue, Frank, is the overall storage area and the place it occupies on the railroad. We don't want it to sit on our railroad for a time. It is not a security issue, it is just that we can't afford to have it do that. Again, I think there is going to be a lot of work with customers and end users to make sure that there is a rational approach to the

business that doesn't pass on, how would you say, unforeseen costs to us or to the railroad to hold this stuff in a particular place. So we are working very hard with our customers on the whole supply chain management issue.

COMMISSIONER MULVEY: This seems to be better addressed to producers at this point than the railroads I would suppose.

MR. KAUFMAN: Yes.

MR. KORALESKI: I would also say that we have seen terrific cooperation with our ethanol customers in terms of dealing with safety and security and all issues associated with the transportation of ethanol as a hazardous material. They have been head and shoulders right there with us in terms of making sure that facilities and everything that we are doing. It is kind of interesting, because it is an industry starting from scratch in some cases. We just have seen terrific cooperation.

COMMISSIONER MULVEY: Not to disagree with my esteemed colleague, but there are some issues with coal, of course. Greenhouse gas emissions and the global environment and all of that. Just recently in Texas, for example, it was

announced that of 11 new proposed coal power plants are not going to be built, they are going to find some sort of substitute for that.

How much of a threat do you think that might be in the long-term to your business, in the sense that if we do move to alternative energy supplies, whether it be nuclear or solar and wind power, what have you. Is there any real threat to the overall long-term demand for coal and the transportation of coal by rail?

MR. KAUFMAN: Coal is by far the cheapest on a B.T.U. basis provider of energy.

COMMISSIONER MULVEY: Take me to the whole full course.

MR. KAUFMAN: It is very inexpensive, so it buys its way into the mix. Now, the issue, of course, is the public policy debate, it is a consumer debate, is how much is the consumer willing to pay for their electricity using nukes or whatever you want to have. Sometimes I think I am living in the new world, where you live long enough and everything comes around full circle. One thing that was excoriated 15 years ago, 20 years ago is now the new environmental friendly.

CHAIRMAN MULVEY: And yesterday

unfortunately.

MR. KAUFMAN: So it is interesting. But we look at coal as being a very inexpensive alternative. And I think Jack even talked about the movement to the west coast for export. If U.S. consumers don't want to buy it, globally there is huge demand for it as well.

COMMISSIONER MULVEY: Jack?

MR. KORALESKI: Not in my lifetime. I think coal demand will be strong for a very, very long time.

COMMISSIONER MULVEY: Thank you.

VICE CHAIRMAN BUTTREY: I have nothing further.

COMMISSIONER MULVEY: Thank you very much.

VICE CHAIRMAN BUTTREY: Thank you very much. We will call Panel 2. See if I include everybody the first time around this time.

CSX Transportation, Inc., Norfolk Southern Railway Company and Kansas City Southern Railway Company.

Thank you very much, gentlemen, for being with us today. We usually go from this side to this side if that's okay. We don't want to

offend anybody. We will start with Mr. Selby. Good morning, Mr. Selby. You may proceed whenever you are ready.

MR. SELBY: Good morning. Thank you Vice Chairman Buttrey and Commissioner Mulvey. On behalf of the Kansas City Southern Railway, we all welcome you to Kansas City. I am Darren Selby, Assistant Vice President of Sales and Marketing in the coal business unit. I am pleased to present this testimony on behalf of the Kansas City Southern Railway in response to the STB's announced hearing on the subject of efficient and reliable rail transportation, a resource that is critical to the nation's energy, including coal, ethanol and biofuel.

To date, KCS has relatively limited experience with the transportation of ethanol and biofuels. We have one client currently on the KCS in the State of Missouri, and one that is in construction in the State of Mississippi that should be on line in early 2008.

We have had numerous inquiries from companies wanting to site ethanol plants on the KCS, but most of these -- in nearly every state we ship to, but most of these inquiries do not make

it past the feasibility phase of their analysis.

We have one biodiesel plant under construction, it is in the State of Missouri. It should be on line in early 2008.

Because we do not have a vast experience in ethanol and biofuels, I will concentrate our testimony today on the coal transportation on the KCS.

In 2006, KCS transported about eight and a half percent of all the Powder River Basin coal produced. We receive all of our coal in Kansas City from either the Union Pacific or the BNSF Railway. So we are a relatively small member of the overall supply chain. We are only a terminating carrier. Unlike our Class 1 counterparts that are located east and west of our system, who they both originate and terminate coal, we are, again, just a terminating carrier. Powder River Basin Coal represented 22 percent of our total volume in 2006, and nearly 16 percent of our annual revenues in the same period.

There are two elements necessary for the KCS to maintain and improve the efficiency of its coal movements. One being, we must earn revenues adequate to attract the capital necessary to

support infrastructure improvements. And two, Government policies must encourage the efficiency of the overall coal network and not focus exclusively on the rail component of that network.

As revenues have increased in the past few years, capital spending on infrastructure and equipment has also increased on the KCS. This will not continue if KCS is faced with laws, regulations or policies that artificially cap revenues or prevent the KCS from covering its fully allocated costs and earning costs of capital.

To be viable and effective in the years ahead, especially in the face of projected huge increases in transportation demand, KCS must be able to maintain and replace its existing infrastructure and equipment and to build substantial new capacity to handle projected growth. If the regulatory and economic environments remain largely as they are currently, KCS will be able to meet this challenge.

KCS plans to focus on three major areas to handle the projected growth. Line capacity expansion, terminal improvements and locomotive acquisitions. These planned improvements will

benefit our entire railroad, but will directly improve our ability to serve the coal market.

For locomotives, KCS put 33 locomotives into service in 2006. In 2007 we plan to add 120 additional new six axle locomotives with the next delivery of 30 scheduled to arrive this quarter. These locomotive acquisitions will improve the overall age of our six axle fleet by five percent.

KCS believes we provide excellent service to our coal burning utilities, but we do not operate alone. We have help from our origin railroad connections in Kansas City. Through good daily communications, we plan for peaks in the traffic volume and we can route trains through the city so all traffic flows efficiently.

Working together with the Kansas City community, the railroads have been able to build flyovers, reconfigure rail yards and add staging tracks. All of this is needed to allow the railroads to handle coal through the city efficiently.

On the KCS we have been expanding line capacity over the past few years. New sidings have been added, double track has been completed. A new mainline fueling facility was built and

power switches have been installed. KCS is continuing to add strategic sidings on its coal routes to improve overall efficiently.

While it is proper and right for the STB to examine the railroad industry's ability to adequately and efficiently handle the movement of coal and other commodities necessary to produce energy, government policies cannot and must not focus exclusively on the railroad component of the energy supply network. And network is the key here. The other members of the energy supply network, none of which the railroads have direct control, are the loading of the trains at the mines, the unloading of the trains at the utilities, the size and types of the utilities' fleet, rail car fleet, and the pricing, marketing and inventory policies of the utility industry.

The STB can and should play a role in facilitating dialogue and encouraging communication among and amongst the various components of the network. Those being the coal mine owners, the railroads, the utilities and the government decision makers.

To this end, KCS encourages the STB to continue with its fact-finding hearings to help

facilitate continued dialogue and to help encourage and support the development of more infrastructure, and to support the continued long-term financial viability of the rail industry. Thank you for your time today.

VICE CHAIRMAN BUTTREY: Thank you very much. Mr. Smith. Welcome.

MR. SMITH: Thank you. It is good to be here today with everyone. My name is Danny Smith, I am Senior Vice President of Energy and Properties for Norfolk Southern, and responsibilities include the coal business group as well as our real estate group for the property side of it, but also Pocahontas Land Corporation, which is a subsidiary that owns about a million acres of coal properties, principally in Central Ap, but also we have a little bit in the Illinois basin. We have owned those properties going back to the early 1900's. That is principally focused on coal.

Coal as a commodity for Norfolk Southern accounts for 25 percent of all of our revenue in 2006. So to say it is very important would be very much an understatement there.

We serve coal fields in Virginia, West

Virginia, Kentucky, Pennsylvania, Indiana, Illinois, Ohio, Alabama, Tennessee, which covers Northern Ap, Central Ap, the Illinois basin, Southern Appalachia and all of the major fields in the east.

The east is fundamentally different from the coal fields in the west. I think you know that, but I think it is incumbent upon me to bring that out a little bit. We are serving, we are lining up serving about 140 mines out in the various coal fields, going to roughly 90 destinations on the utility side. We serve mines that actually have various qualities of coal in those 140 mines. We will serve mines that have metallurgical quality coal, ship into that market, whether it is export or domestic, but also to the industrial market, and then also to the utility, all from the same load-out, which complicates it a little more. Nevertheless, that's how the east is and we are accustomed to that.

In 2006 we hauled about 148 million tons of utility coal and 9 million tons of industrial coal, which I will mention, because that is principally to supply energy as well. If you look at that, you look at the total coal coke and iron

ore that we move, that is about 77 percent of it is going into the utility market. If you add the industrial side to that, it bumps it up to about 82 percent. So obviously our major market there is on the coal side and our major emphasis.

We have successfully provided reliable, efficient and safe service to our utility customers. And to that point, in 2004, 2005 and 2006 Norfolk Southern set new records for the number of tons transported to utility customers. Growth in N.S. deliveries to utility plants has exceeded the rate of increase in coal fire generation in our service region in each of those years as well. Growth in the Norfolk Southern coal volume has surpassed coal production for each of the major coal producing regions that we serve. And currently many of our customers and some of our largest customers, in fact three of our larger customers on the utility side have cars available for loading. In other words, if you want to say in storage, but available. I like to look at it as available for immediate delivery if the need arises.

All of that would tell you, if you take all of that into context on that front, tells you

that the stockpiles have risen certainly compared to last year, but they are either at or above the targets. And those are individual targets set by utilities and not by us.

Norfolk Southern has had this success despite the shifting transportation patterns that have merged in the recent years. Utilities have been shifting their strategies for where they purchase coal. And sometimes it is on short notice. Since 2003 the volume of coal Norfolk Southern has shipped from Central Appalachian region, for example, has decreased 11 percent, while coal shipped from other origins has increased 32 percent. So that is very significant. And those changes may require infrastructure changes and a lot of times they do, but more significantly they absolutely do require modifications in their operating plan.

Crews, empty cars, locomotives must appear where they previously hadn't, or in more quantity than they had before. And because it is a network, I mean, that affects the entire system. Where we are pulling from other areas, we are trying to get out in front and make sure that we get the proper employees and equipment to the

right spot to meet those needs.

We are continuing to work for a successful coal network. We are replacing our coal car fleet. We started that this year very significant, which has been published. I know our chairman has talked about that as well. When we replace those coal fleets, we are replacing those with bigger cars of 10 percent or more gain on the tons per car that we can haul, which creates capacity for that. And we have worked with designing new cars that are being made for us to meet that need.

I think that is very important for us, as about half of our coal that is moving is moving in our cars. And with the various qualities that I mentioned, and the complexities of the east, having more of the cars owned by Norfolk Southern is a benefit to our coal suppliers who may have various qualities of coal on any given day. So it gives them the flexibility, if they don't have that quality to meet some customer, if it is in our cars, they can ship it to another customer. When it is a private fleet, it has to go to that one customer. So that gives us the flexibility.

We are continuing to redesign and look

at our network, looking at scheduled coal trains and will continue to do that. We have gained some efficiencies in that. We are working hard to communicate with our coal customers. We look at that as a three legged stool. You have got the suppliers, you've got us and you've got the utilities, and we're working together to make sure that we match everything up so we continue that dialogue.

Coal service depends on infrastructure. It takes money, obviously. That has been mentioned this morning. We are no different. Locomotive purchases obviously require lead time. Track investment requires lead time. Certainly if you have to put in new track, you have got environmental as well as other issues to meet there, too. These assets are long-lived and very expensive. We have to do it right.

I am not the ethanol guy. We filed comments on ethanol. Ethanol is an emerging market, important to us. If you compare it on the coal side, it would be roughly two percent of the number of cars we move on coal, but it is an important market to us in the future, but it is going to be small in that.

We appreciate being able to come here and file these comments. Thank you.

VICE CHAIRMAN BUTTREY: Thank you, sir. Appreciate you coming. Mr. Jenkins.

MR. JENKINS: Good morning Vice Chairman Buttrey. Commissioner Mulvey. I am Chris Jenkins, Vice President of Coal and Automotive Service Groups at CSX Transportation. With me today is Tim McNulty Director of Marketing for Agricultural Products. And Tim's responsibilities include ethanol. We have a few slides. We are going to use those to address coal first and then discuss ethanol.

We appreciate the opportunity to be here at this hearing and to talk about the essential role that railroads play in the transportation of energy. Next slide, please.

Railroads are critical in terms of helping alleviate our nation's addiction to oil. Efficiencies generated by the rail mode are substantial, commonly estimated at four or five times the efficiency of the motor carrier industry with respect to fuel usage. Our business on CSX has grown, and while it has grown we have actually been able to reduce our annual fuel consumption.

So there are efficiency gains possible in the rail mode.

We are increasing capital investment on CSX. We have moved from a historical level of about $1 billion a year to 1.4 billion in 2006, to a similar, actually slightly larger number in 2007 of close to 1.5 billion. We have projected that that number will continue to increase.

We believe that good public policy should support conversion of traffic to the rail mode to gain efficiencies, and we support those efforts. Next slide, please.

As background, the coal transportation on CSX, we are about 190 million tons a year, slightly more last year, but 190 is a good working figure. We serve 130 loading points in nine states. And in a typical week, about 31,000 carloads of coal would be loaded on CSX, and another 4,000 would be received from other rail carriers for delivery to CSX customers.

77 percent of the coal we move ends up in electric power generation. So we do move it for other markets, such as export industrial steel making, but really at the heart of it is electric power generation. Next slide.

This is a chart that shows since 2002, January of 2002, the weekly volume of coal that we have handled on CSX, carload volume that we have handled on CSX. And you can see that that has risen from about 30,000 to a total of 36,000 or so this year. That is an order of magnitude of 20 percent increase. It includes both the loads that we originate, as well as the loads we receive.

Now while this pattern shows continuous growth looking from 2002, if we go a little further back in time, next slide, we see more of a saw tooth pattern. This is a pattern that is somewhat consistent with the boom and bust pattern in the eastern coal industry. It is the case that in 2001 we had extremely strong demand for transportation. That weakened considerably in '02 and '03, began to recover in '04, then '05, '06 and thus far '07 have been reasonably strong years for coal transportation demand. Demand on our railroad system.

Now the difference between the peaks and valleys here is pretty significant. It is about 20 million tons a year, which is 200,000 carloads. So this cycling is significant. And what you have is that during the periods of strong demand, they

are typically characterized by rising coal prices, scarcity of coal, and strong demand for transportation and sometimes perceived shortages of transportation capacity. And then the weaker periods, what we call the bust periods, are characterized typically by falling coal prices, by excess transportation capacity, and sometimes this is quite severe. If we go to the next slide, please.

In fact, looking at that 2001 peak, and then the fall-off in 2002, this is a cut-out from our quarterly earnings for July of 2002. Just about exactly five years ago. And at that point we had passed the market peak and we said, Hey, most of our other markets are looking pretty good, but coal is weak, and it is weak because utility inventories are high. If we go a little further to the next slide, please.

We actually had to issue an earnings outlook by the fourth quarter -- pardon me, by the third quarter of that year, due to weak coal traffic. This period of weak coal traffic was characterized by gross excess capacity on our system, including thousands of shipper and system owned cars in storage due to lack of loading.

Next slide, please.

Underlying that is a pattern of changes in utility inventory levels in the east. Commissioner Mulvey, you mentioned the importance and significance of inventory. What we see, of course, are significant changes in inventory levels that correspond roughly to the changes in demand for transportation. When inventories are being built, that is to say when coal stocks are rising, transportation demand is strong. And during periods of inventory depletion, transportation demand is weak.

I think one of the most significant things in this chart is that whenever the line is sloping up for a sustained period, it means that the transportation system in the east is delivering coal more quickly than it is being used by the utilities. We are building inventory. So we had a period of building in '01 and into early '02, and then a very significant and sustained period of building beginning in '05 and continuing through the present. Today most measures of utility inventory say that we are at a record high level for the decade and that we have now been running more than two years with deliveries in

excess of burn. Next slide.

To summarize for coal, we think that it is an issue of communication and planning. Good planning can only help in this kind of a market, where there are natural cyclical changes and where there are sourcing changes. Communication between the railroads, the coal users and the coal producers can produce better plans, perhaps reduce some of the cyclicality that wastes effective capacity.

There are also smaller opportunities to improve efficiencies throughout the system worked by railroads to -- what we are doing to reduce train cycle times, work with customers to reduce unloading times. With that, we'll reintroduce Tim McNulty on ethanol.

MR. MCNULTY: Thank you. Thanks, Chris. Production of renewable fuels certainly offers an exciting opportunity to the agricultural industry. It is hard to pick up a piece of correspondence that doesn't address or offer an opinion on, Are we producing enough renewable fuels? Should we produce more renewable fuels? We have heard numbers taking it up from the current mandate of seven and a half billion gallons to as high as 35

billion gallons in some instances.

As those production increases are forecasted or contemplated, the inevitable question is, Can we transport it, and specifically, can rail handle their portion of that? CSX has created this slide over my left shoulder that addresses that issue, and perhaps Commissioner Mulvey provides some scale, at least from CSX's perspective, of how we feel about this market.

Some might consider this a worse case scenario. I personally would consider this a best case scenario from a railroad perspective. It is ladened with assumptions to say such that if 35 billion gallons of a mandate was put in, of 35 billion gallons of renewable fuels, and assuming that that 35 billion gallons was all ethanol. And if all 35 billion gallons moved rail, and if those gallons were equally split between the population centers in the east and the west, and if CSXT handled 50 percent of the eastern movements, and since there are two Class I carriers in the east, CSX handled 50 percent of the eastern movements, then the increasing carloads would only be four percent of current CSXT traffic.

So if all those assumptions took place, and again, this is a simplistic mathematical function of how it would look in the market, it would be the equivalent of four percent of CSXT's current transportation.

What it does not address, of course, is the destination terminal capacity, the origin efficiency capacity, and certainly the availability of freight cars. To this end -- the next slide, CSX has built our ethanol strategy on three major themes in an attempt to encourage efficient seemless logistics.

Number one is efficient asset utilization. Essentially speed. Move the freight cars as fast as possible, get them into the terminal that can unload them as quickly as possible, and keep the assets moving efficiently.

Number two, economies of scale where practical. If a market has the scale to consume unit train quantities or the population to consume unit train quantities, we want to move it in unit train quantities. If the market has the ability to accept more than one unit train facility, we want to create more than one unit train facility.

And thirdly, create options for our

customers. Certainly not every market is going to be able to accommodate unit trains. Certainly not every customer is going to be able to accommodate unit trains. So we have created a network, or are attempting to create a network that allows for that flexibility for our customers and give them options on how they want to handle their ethanol into a given market.

The next slide specifically talks about our northeast strategy. Our logistics in the northeast rely on our primary double track mainline high speed corridor from New York -- from Chicago up to New York. Given that most of our ethanol at this point in time is received over Chicago. And we move traffic in three days from Chicago up into the New York metro area.

Based on that service product or service offering we have built a terminal network up in the northeast that consists currently of four high speed unit train unloading facilities, ethanol unloading unit facilities; one in Albany, New York, one in Seaborn, New Jersey that have been in existence for the past couple years.

Two months ago a unit train facility in Baltimore, Maryland opened up. Two weeks ago a

unit train facility in Providence, Rnode Island opened up, and by the end of 2007, a fifth unit train facility will open up in Linden, New Jersey. All of these facilities have the capability to receive 80 cars of unit trains and can unload those 80 cars in 24 hours or less, thereby providing service from Chicago loaded to Chicago empty in ten days or less.

Again, capitalizing on the fact that we want to have speed within the logistics environment, and secondly, we want to provide options for our customers. All those facilities can also handle less than unit train carloads as well.

The next slide deals with the entire eastern part of the country, whereas the northeast is densely populated and it has the ability to support unit train markets, there are several developing markets in the southeast that don't necessarily accept unit trains. To this end we have our Transflow Network that has capability to handle ethanol in less than unit train shipments. We can rail it in, transfer it to trucks and then deliver it to the ultimate refiners for truck delivery. These facilities offer a couple of

different dimensions. One being, if a market is developing, and someone doesn't have to invest the capital to put the infrastructure in place, they can use this as a method to enter into that market initially. And/or if ultimately the market doesn't have the consumption that is necessary to support unit trains, they can use our transport terminals to handle product into that market on an ongoing basis.

Between our terminal infrastructure, our Transflow Network and the number of shipments that go into the refineries directly, CSX is prepared to handle ethanol even if it does reach the 35 billion gallons, which will be the ultimate mandate.

In summary, continued development of domestic energy resources is important to CSX and it is an issue that we take very seriously. We are willing and endorse the participation in any appropriate committees addressing energy related transportation issues. We appreciate the opportunity to speak before the Commission and are happy to answer questions at this time.

VICE CHAIRMAN BUTTREY: Thank you, sir. We appreciate all of your statements. I will turn

the floor over to Commissioner Mulvey.

COMMISSIONER MULVEY: Thank you very much. I am not a copyright lawyer, but I wanted to express some concern about the Ethics logo. Has Nike seen this?

MR. MCNULTY: They have. And we have had that debate.

COMMISSIONER MULVEY: I noticed that a lot of the ethanol is moving through Chicago from I guess the B.N. and the U.P. How important is the Freedom Project at Chicago to the efficient movement of ethanol through Chicago to your system and then on to the east?

MR. MCNULTY: Well, in general it is critically important that we move seamlessly through Chicago. To that end, we are doing as much joint connection, direct connection as possible with the western carriers, and in fact in some instances have had the state directed the train, and carries it right through to destinations.

COMMISSIONER MULVEY: So you continue to be fully supportive of the Freedom Project then?

MR. MCNULTY: I am not familiar specifically with the project, but yes.

COMMISSIONER MULVEY: You mentioned that four percent increase in the ethanol, if it would all move to east by CSX, et cetera, would be a four percent increase in your overall traffic and you said that that is not much of a big deal. But a four percent increase at the margin -- I am an economist, so we are interested in the margin. A four percent increase is still a substantial increase, especially in a capacity constrained environment, and especially since that four percent is not going to be distributed throughout the entire system. Are there any places where you see bottlenecks in the overall transportation infrastructure that would have to be addressed in order to smoothly handle such an increase?

MR. MCNULTY: Four percent is a big deal. I would agree with that. Four percent increase in traffic is very attractive to CSX. But again, relative to the overall scope of things and the capacity that is necessary specific to ethanol, we feel that we can handle that. And couple that with the development of the infrastructure at destination, which does encourage train load quantities and fast unload of those trains. So when you couple those two, we

haven't to date experienced bottlenecks in any situations, nor do we expect to as that develops.

COMMISSIONER MULVEY: There was some discussion of the coal stockpiles. And we were out visiting KCPL yesterday, and they were explaining to us how they have changed what they consider to be a safe stockpile to ensure that they have sufficient supplies in case of spikes in demand. It was fairly significant.

Do the utilities communicate to you when they have changes in their long-term plans with regard to what stockpiles they plan to hold? They have gone from 20 days to 40 and 50 days, and that is a substantial amount. They have gone from 13 trains a day to 19 trains a day to keep up their stockpiles. Do they let you know that this is their plan and therefore you should be making your plans to accommodate that?

MR. JENKINS: I think the answer to that in general is yes. There is, of course, constant dialogue between us and our utility customers. And a lot of that dialogue involves expectations with respect to future deliveries. The utility, of course, doesn't always have perfect knowledge about what they are doing. And in some cases they

are reluctant to reveal their full plans to us, because it could hamper their ability to buy coal as cheaply as they might. In other words, they might not want to have it known that there was a big inventory build coming, for fear that they would pay more for their coal. But in general, yes, there is good communication there. Probably some room for improvement, but pretty good.

COMMISSIONER MULVEY: In the chart you show basically almost a rollercoaster view of the stockpiles being held by the utilities. To some extent I would suppose that would be due to excessive burn or higher rates of burn due to weather. But clearly that wouldn't entirely be weather. Is this a reflection mostly of changes in their strategy for how much they want to hold in their stockpile?

MR. JENKINS: I think that is probably the biggest single factor. You are exactly right, that weather can play heavily into it. The relative price of coal versus natural gas can play into their burn decisions. Plant outages or maintenance can play into their burn decisions. If we are not doing everything correctly, that can affect the amount of coal that is delivered. But

in general, I think it is a financial decision that is based partially on inventory carrying costs, and partially on what the utility expects future coal prices to be. If they expect coal prices to continue to fall, then they are often willing to let their inventories run down.

COMMISSIONER MULVEY: Norfolk Southern talked about the investment they are making in their coal car fleet. Is about half of your fleet, coal car fleet company owned and about half of it is owned by the utilities?

MR. SMITH: That is correct.

COMMISSIONER MULVEY: Are you changing that ratio? You sort of suggested that there are a lot of benefits to having a fleet owned by you. Do you have any plans to increase the percentage of coal cars owned by the railroad?

MR. SMITH: We balance that. In looking at our system today, we think we have got a good balance on that. We have had some private cars from utilities come in in the last two or three years and some increase on that. But obviously we want to maintain some level to that, and it goes with our investment. Obviously it is not cheap to buy those coal cars in those type quantities, and

we are going to do that over a number of years. We think we have got a good mix right now on percentage.

COMMISSIONER MULVEY: You mentioned the export market. The export market seems to have been somewhat volatile in recent years. Do you have any short term forecasts of what your export market for both Met Coal and other kinds of coal is going to be for the next year or two?

MR. SMITH: I think the export market is one of the markets that has been in demand this year, principally into Europe. I just came from a conference a couple weeks ago in New York where all of the major coal C.E.O.'s were there, and we had some consultants also in there too predicting that. And they think that the export market is going to be strong. And we would agree with that.

COMMISSIONER MULVEY: That is export mostly to Europe at this point?

MR. SMITH: That is metallurgical coal mostly going into Europe.

COMMISSIONER MULVEY: Your company is primarily, in terms of originating coal, originating from Illinois, and Appalachian region. Of course, that has been tapped for some time now.

We always talk about the Powder River Basin being America's Arabia with regard to coal. That is probably less true in Appalachia, although your coal does have higher BTU value. Is there any concern about the long-term supply availabilities of eastern coal?

MR. SMITH: We always look at that in relation to the overall coal market, but it depends on what the utilities, and looking at that market, and what they are willing to buy. I think it is a function of price and the investment for the coal companies. So it is more of a question for them. Obviously we have got an infrastructure in Central Ap and we would obviously want that to continue. Although it has dwindled, some would predict a larger decline than in the past few years. I have seen that over the past four or five years. They predicted a larger decline than actually happened. I think part of that was because of price. We would hope that would continue going forward, because obviously we have got the infrastructure in Central Ap to handle the coal right now.

COMMISSIONER MULVEY: So output in whole in eastern coal has been higher than the Energy

Information Administration has forecast?

MR. SMITH: That is correct, and other pundits, too. We have seen the increases, obviously as I said in my remarks, we have seen increases from other areas. And principally the biggest increase has been Powder River Basin coal moving to the south.

COMMISSIONER MULVEY: Kansas City, you mentioned about these hearings being a good idea and you encourage us to continue to hold them. Do you have any other ideas for the STB that we might do, actions we might take that would be supportive of the major transportation energy infrastructure? Transportation movements, energy movements?

MR. SELBY: I don't know if it is more what actions you should take, it is more what we would like not to see is more regulation and more policies that may hamper the ability for us to do what we do best, which is to move trains and operate the railroads. So I think any barriers that can be held down would be the best at this time.

COMMISSIONER MULVEY: Of course that is not our decision. We do what we are told.

MR. SELBY: Right.

COMMISSIONER MULVEY: Thank you.

VICE CHAIRMAN BUTTREY: Mr. Jenkins, you had a slide up that said that -- you mentioned that the percentage, 77 percent of the coal delivered is for energy production. I am assuming all the coal that is moved is for energy production, but the difference between the 77 percent and 100 percent is export coal, is that correct?

MR. JENKINS: What I intended to say with the 77 percent, was that that was for electric power generation. We don't include deliveries to a heating plant at a university, for example. That would be in the other part. Export would be in the other part. Coal to steel making would be in the other part. So the 77 percent is best to think of that as electric power plants generating commercial electric power.

VICE CHAIRMAN BUTTREY: You are talking about that little school down in Athens I guess you are talking about.

MR. JENKINS: There are a few of those around, actually. University of Virginia is another example, yes, sir.

VICE CHAIRMAN BUTTREY: Mr. Smith, you

were talking about the percentage of coal delivered. You have a huge blending operation. I think I may have seen a little piece of it at one time on a fact-finding trip. What percentage of the coal that you actually deliver is blended coal?

MR. SMITH: I'm not sure what you are talking about on the blending facility.

VICE CHAIRMAN BUTTREY: My understanding is that you blend metallurgical coal, you take the metallurgical coal and --

MR. SMITH: You are talking about Lambert's Point which is an export.

VICE CHAIRMAN BUTTREY: Yeah. You don't blend any domestic deliveries?

MR. SMITH: No.

VICE CHAIRMAN BUTTREY: You only blend foreign bound product.

MR. SMITH: That is foreign bound, and set by the coal suppliers that have that. Various qualities of metallurgical coal making a blend for the furnaces in Europe, which can be low-vol coal, high-vol coal.

VICE CHAIRMAN BUTTREY: The customer determines that?

MR. SMITH: The customer determines that. They tell us that, and we have the capacity to do that because it is in cars.

VICE CHAIRMAN BUTTREY: Are you free to say what percentage of your total coal volume now -- you may not be free to say this, but if you are, I would be interested in knowing, if you have said it before in public, what the percentage of your coal that you are moving now is still under contract, old contracts that may be expiring soon, or is it mostly TERA freight traffic? Can you comment on that or are you not free to do that?

MR. SMITH: That I'm not --

VICE CHAIRMAN BUTTREY: I see one of your lawyers in the audience. You better be careful.

MR. SMITH: He will throw something at me. I mean, most of what we move is under contract.

VICE CHAIRMAN BUTTREY: Most of what you move is under contract. Okay. As those contracts expire, those prices move to market, I suspect that is something that is going to be happening in the near future?

MR. SMITH: Well, as any contract goes

out, we are trying to price into the market.

VICE CHAIRMAN BUTTREY: Right. Do you have any feel for what the difference between the average maintenance cost on a non-rail line of track and a rail line of track would be? I make the assumption that on your particular railroad you move through a lot of mountainous areas with a lot of curvy track and mountainous track, changing grades, et cetera. Some different speeds at different times depending on the terrain.

I would suspect that your track, to maintain that track in your part of the world, as opposed to maybe the western roads which operate a lot of straight line track. Not all, I know that is true, not all -- some people shaking their head -- is not straight line track, but you've got a lot of curvy track in your part of the world. I was wondering if you had a feel for the difference between the maintenance costs of operating that line of traffic and the other line of track that is not exposed to the pounding of the coal traffic every day? Which I presume is the heaviest traffic you carry.

MR. SMITH: That's true. But I really don't have a feel for that. Their network would

be very similar to CSX in the same terrain, just maybe on the other side of the mountain. Certainly when you have to look at working in those areas, because there is limited access getting to some of that track, it is an issue. I really don't have -- I am not the one to ask for the feel on what --

VICE CHAIRMAN BUTTREY: You come over the eastern side of the mountains through Roanoke and where else?

MR. SMITH: Roanoke. A lot of our south traffic is going to Roanoke or going over to Chattanooga, that way, going into the southeast.

VICE CHAIRMAN BUTTREY: Down through Kentucky and Tennessee.

MR. SMITH: Going into the northeast, going through Portsmouth, coming out at Conway and those areas of Pennsylvania.

VICE CHAIRMAN BUTTREY: Do you do any export in the north? Do you do export traffic out of the northeast?

MR. SMITH: We access the Baltimore terminal there of CNX.

VICE CHAIRMAN BUTTREY: That is as far north as your export track goes?

MR. SMITH: I mean export principally is Baltimore and Lambert's Point. And Lambert's Point is the biggest.

VICE CHAIRMAN BUTTREY: The calculations that I have done, or tried to do, indicate to me that on average revenue per ton mile for coal is the lowest revenue per ton mile that the railroads generally get. Is that true? Would you agree with that?

MR. SMITH: I think that's true. I haven't looked at that, but I know that looking at the AAR data, as a general rule that is true.

VICE CHAIRMAN BUTTREY: You talked about the facilities in the northeast where you have fairly -- excuse me. It was you, Mr. Jenkins, was talking about -- no, it was you, Mr. McNulty that was talking about your unload facilities in the northeast for ethanol. I presume that those facilities are relatively new?

MR. MCNULTY: Yes. Two of the four just opened up this year and the other two are relatively new.

VICE CHAIRMAN BUTTREY: Who is paying for those?

MR. MCNULTY: Really it has been a

combination of private investment. And in one of the facilities we actually have an investment in Albany. We had to make some track infrastructure improvements around those facilities as well.

VICE CHAIRMAN BUTTREY: The other facilities, the other four and then the five that you said the last one is coming on, is a company that is neither the coal company or the ethanol producer or the railroad, or the city or the port or anyone else, some third party has come in and said, Hey, we want to build this thing for you, we want to operate this for you. We will build it, open it, operate it, all you've got to do is drive your trains in here and we are going to unload them and that's it. Is that the way it works?

MR. SMITH: Three of them are that way and two of them are, they have oil interests as well. So they actually consume the ethanol as well as sell it to the open market through their facility.

VICE CHAIRMAN BUTTREY: So actually the gasoline companies or --

MR. SMITH: Correct, on two of them.

VICE CHAIRMAN BUTTREY: -- oil companies, that are going to do the blending

process for the ethanol, are actually --

MR. SMITH: On two of the facilities. The other three are independent third-party operators as you described.

VICE CHAIRMAN BUTTREY: Independent investors. I think that concludes my questions.

COMMISSIONER MULVEY: I have no more. Thank you very much, gentlemen, for coming.

VICE CHAIRMAN BUTTREY: Before we do the next panel, Panel 4, we are going to take about a ten minute break. We encourage everyone to be back in about 10 minutes. Thank you very much.

(A short recess was taken.)

VICE CHAIRMAN BUTTREY: We would like to proceed with our hearing this morning. With Panel 4, Coal Shippers and Utilities. Arkansas Electric Cooperative Corporation, Western Fuels Association. What? Sorry about that.

Panel 3, Coal Shippers and Utilities. We have with us today representatives from Western Coal Traffic League and Edison Electric Institute for 10 minutes each. Gentlemen, you may proceed.

MR. LAFFERE: I would like to begin my comments by thanking Vice Chairman Buttrey and Commissioner Mulvey for providing a forum to

discuss the current rail transportation environment. I am here today as both a representative of the Western Coal Traffic League and as manager of Kansas City Power & Light.

As an organization, WCTL members transport roughly 140 million tons per year of PRB coal that originates on the Union Pacific and the Burlington Northern Santa Fe.

In the Board's notice regarding this meeting, you asked that views and information about issues relating to the efficiency and reliability of rail transportation and the resources critical to the nation's energy supply be shared. WCTL has supplied written comments to the Board on this issue, and I would like to supplement those comments with a few of my own observations about the industry.

Like most people in this room, I can tell you about the importance of coal in meeting the country's increasing energy needs; the plans by utilities to invest hundreds of billions of dollars in generating and transmission assets, and the obviously critical role that reliable and economic rail transportation service plays in this process.

I could also recount sleepless nights trying to find ways to keep generating facilities from running out of coal over the last few years. Recommendations to management to spend tens of millions of dollars on new rail cars, to make up for erratic rail performance. Multi-million dollar investments in coal unloading facilities and track improvements, and increasing shipper frustration associated with rail service quality and rate increases.

On the other hand, I could also talk about the respect and friendships I have developed with many of my counterparts with the carriers. Over the years, relationships with people such as Lance Fritz, Doug Glass, Rick Gough and Tim Gilg at the U.P., along with Tom Kraemer, Steve Behn and Gary Haller at the BNSF and Darin Selby with the KCS who spoke earlier, have allowed us to resolve many contentious issues through negotiated settlements.

Unfortunately, these compromises are becoming less common as road carriers have pushed an ever more aggressive agenda to drive up their financial performance while de-emphasizing service commitments.

Over the past few years we have seen implementation of maintenance practices that push rail car inspection and repair cost up for shippers, while reducing carrier track maintenance cost. The unilateral imposition of public pricing programs and fuel surcharges which have had no correlation to the actual fuel expense for a specific move, and which utilize the base period that did not take into account when the underlying freight rate was issued.

Just two days ago in the July 16th issue of Argus Coal Daily, a story ran on the front page that the BNSF is expected to impose coal dust control standards in the coming weeks that will require the chemical treatment of loaded coal cars. Through organizations such as National Coal Transportation Association, shippers have asked since mid 2005 to be involved in determining the best course of action related to coal dust.

However, one carrier made their intentions clear before any data had been collected or economic analysis had been performed, that only one resolution to the problem would be chemically to treat each load.

Shippers I know and have spoken with

would agree with Chairman Nottingham's statement that the jury is still out on the best course of action related to coal dust. Additionally, mines and shippers have been working with the carriers to minimize dust by increasing the size of coal being shipped, modifying mine loadouts to change the contour of the coal in the car, and performing maintenance on the cars to minimize leakage. A cooperative effort that should be applauded.

The remaining contentious issue is the chemical treatment of rail cars, which is expected to cost roughly $50 million annually. To date I have not seen the carriers indicate they are willing to pay any portion of this cost. Consequently, among the shipper community it is viewed as one more program to shift costs from the carriers to the shippers, who already are paying an ever-increasing rate for services that has been anything but consistent.

In the 14 years that I have been associated with rail transportation, I have seen the natural tension between shippers and rail carriers steadily escalate as the number of carriers was reduced. Carrier promises made during merger proceedings of better service and

lower rates associated with operational efficiencies stand in contrast to the service disruptions that have been experienced during the past ten years, and the current rapidly escalating rates that are now common place.

When WCTL, DOJ and other interested parties opposed the creation of the western duopoly when U.P. acquired S.P., in approving the merger in 1996, the Board pointed to the widespread use of confidential contracts as a safeguard against carrier collusion. Beginning in earnest in 2004, however, both BNSF and U.P. acted to dismantle that safeguard.

Each carrier moved to standardize public pricing arrangements which provide few meaningful service provisions and take away many of the mutually beneficial terms and conditions that were negotiated during a period of true rail competition. Significant price increases associated with the movement of coal accompanied the move to public pricing. Many shippers are now questioning whether there is such a thing as a competitive coal move, given recent actions by the rail carriers to not bid on certain coal moves, and the pricing differential that is shown on

others. Restricted competition and capacity may be applauded on Wall Street, but in the view of many, they run counter to the energy policy goals that are so important to Main Street.

In the early 80's CNW petitioned the ICC to force the BNSF to foster competition in the Powder River Basin. Despite the BNSF's claims that competition in the PRB would lead to a decline in capital investment and future ability to meet growing demand, the ICC granted the CNW's request, and now we have the busiest rail corridor in the world.

When U.P. felt it was not getting even-handed treatment when it came to PRB loading slots in the 90's, it proposed to go to the STB to review the joint operating agreement, and we now have representatives from both carriers working in the same location to promote system fluidity.

The STB can and should play a major role in now restoring the balance to the field of transportation that is critical to the energy resources. With due respect to the published views of former Chairman Nober, we the shipper community do not believe that promoting the railroads' financial fortunes should be the

agency's primary mission. It is one, but not the primary one.

In a recent conversation with a rail executive, I was asked how I as a coal shipper could not be in favor of a strong rail system. Much like being asked, "When did you stop liking ice cream?" The question was presented in a manner that assumes the premise is correct. I, as most shippers I have dealt with over the years, do support a strong rail infrastructure. Rail carriers are the lifeblood of a coal burning utility, and our success, much like that of the nation itself, is dependent upon a strong thriving rail industry.

However, when you read quarter after quarter about record rail revenues and profits, when you see rail carrier stocks outperform most other market indices, when you experience rail carriers imposing rules and rates that significantly increase the cost of doing business while offering little or no service performance standard, there is an unhealthy imbalance that must be addressed in measured and meaningful ways.

I don't believe enabling a concentrated rail industry to provide monopoly rates without

meaningful service provisions is what Congress had in mind when it deregulated the railroads, but it is what we face today. I respectfully submit that the Board can and should do more to protect the public from abuses, and engage in proactive rail service reliability oversight and establish reasonable railroad reliability standards. I thank you for the time to come and present my views.

VICE CHAIRMAN BUTTREY: Thank you, sir, very much.

MR. LINDERMAN: Good morning Vice Chairman Buttrey and Board Member Mulvey. The sympathy of the Edison Electric Institute family goes out to Chairman Nottingham as well.

I am Charles Linderman, Director of Energy Supply Policy at the Edison Electric Institute on whose behalf I appear this morning. The E.E.I. is the association of U.S. shareholder-owned electric companies, whose members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry.

We appreciate the Board's willingness to

conduct this field hearing today on the subject of rail transportation of resources critical to the nation's energy supply. This morning, of course, I intend to address issues related to the transportation of coal, which is used to generate over half the electricity consumed in the U.S., and the vast majority of which is transported by rail. But I will also address two other rail transported goods that are similarly essential to electricity generation, limestone and ammonia. Without these two commodities, the power sector would be unable to run our emission control equipment, such as flue gas desulfurization, or FGD and selective catalytic reduction, SCR systems, in accordance with prevailing environmental standards. Failure to comply with these requirements carries the threat of not only civil and criminal liability, but also a potential prison time for violations for senior executives.

With the passage of the Energy Policy Act of 2005, reliability has become even more important to the electric industry. Reliable service has always been a key part of every electric utility's mission. But with the restructuring of the North American Electric

Reliability Corporation, NAERC, and the potential imposition of penalties for deviations from industry performance standards, as well as with the Federal Energy Regulatory Commission, FERC, backing up NAERC in enforcing its standards, electric reliability has become mandatory as a matter of federal law.

This helps explain the increased emphasis on reliability of coal transportation that U.C. expressed in the written filings for this proceeding from the electric industry. For E.E.I.'s members, coal transportation must be reliable. Otherwise as we have seen, utilities must consider more expensive alternatives such as coal imports or natural gas.

If necessary, rail service standards or commonly agreed upon matrix should be developed that serve the business interests of carriers and shippers alike. We suggest that an early assignment for the Rail Energy Transportation Advisory Committee -- and let me say, we were gratified by yesterday's decision and statement -- could be consideration of consensus national rail reliability standards, not unlike what the North American Energy Standards Board develops for both

gas and electric utilities and forwards to the FERC for its approval.

Reliability of the electric generation system also requires the transport of materials deemed hazardous to run our environmental control technologies, especially the SCR's. We have undertaken some basic calculations of the volumetric requirements needed for ammonia transportation for an SCR. A 500 megawatt coal fired power plant or one slightly smaller than what we were at yesterday would use about 2,500 pounds per hour, or 210 tons per week, or about 11,000 tons of anhydrous ammonia a year.

Nationwide, the planned addition of approximately 150 gigawatts of SCR capacity to scrub that amount of coal capacity, will require approximately 3.3 million tons of anhydrous ammonia annually. If instead a 20 percent concentration of aqueous ammonia is used, more than five times the volume, or 16 and a half million tons will be required for transportation.

Not only are significant amounts of ammonia needed to maintain future electric reliability, but also significant amounts of lime or limestone to run the F.G.D. units that have

been or are being installed. And they are the ones that control the sulfur dioxide emissions. Each F.G.D. unit operating on a 500 megawatt power plant may require up to 150,000 tons of limestone annually. The volume will be less if lime is used, but there are significant cost increases associated with the use of lime instead of limestone.

The legal precedence established with respect to transportation of spent nuclear fuel and nuclear waste, including to the Yucca Mountain repository, can be applied to the transport of Hazmat commodities such as ammonia, required for environmental compliance at coal generating stations as well. The transportation of not only coal but also lime or limestone, aqueous or anhydrous ammonia and nuclear waste are all critical to the nation's energy supply in our view. Accordingly, we are prepared to work with the carriers and their association to resolve the issues associated with the transportation of these commodities.

A logical question, given the current discussions about environmental concerns in the nation might be, is the electric industry in the

market for more coal fired power plants? The answer is an emphatic yes. And we need the rail industry to deliver that coal.

The third attachment to my written statement is a list of planned coal fired units in the U.S., with those where construction is already underway listed first. The total is nearly 80 gigawatts, representing a capital expenditure for the new generators of about $80 billion. Note that I said 80 billion. In the electric industry we understand investment numbers that begin with B., because that is what we face for generation, transmission, distribution and environmental control. And it is in the tens of B's and approaching the T. level.

While we sympathize with and support the railroad's need for capital investment and for the returns necessary to support those capital expenditures, we face the challenges of generating capital in a regulated industry. Whereas in this context, the railroads are essentially unregulated.

Speaking of generating capital in a regulated industry, our industry has taken note of recent calls from Wall Street in May that

"Carriers should stop subsidizing shippers" close quote. And that the railroad should raise rates seven percent annually for a 10 year period to effectively double rates.

As I previously indicated, our capital cost requirements in the future are tens of billions of dollars. We are going to need predictability and stability in operational costs to assist in managing large capital requirements.

You need look no further than Richmond and Anapolis to see examples of the political reaction that can result if the public perceives that rates are becoming too high for a regulated industry. We believe that many coal rates are already quite high, even in excess of stand-alone costs, the obstensible rate standard. So we are hopeful that you will recognize and acknowledge that coal has carried the railroad industry since 1980.

Now that the railroads have capacity constraints and are able to raise rates for most or all of their movements, and especially because the railroads are prospering, it is time to provide rate relief to coal shippers, not allow the railroads to raise their rates even higher

than before.

I might remind the investment community that the SAC standard is based on replacement costs, so there is no argument that coal shippers are not paying our fair share, if not more so.

It is clear in light of recent stock buybacks that the railroads do not need to keep raising rates on coal traffic to raise the capital they need. Again, thank you for permitting me to testify on behalf of the Edison Electric Institute and I look forward to your questions.

VICE CHAIRMAN BUTTREY: Thank you, sir. Commissioner Mulvey.

COMMISSIONER MULVEY: I asked this question of the railroads before, and that is how do you go about communicating -- when you have changes in your stockpiles -- I remember years ago the utilities decided to reduce the stockpiles that they were holding because of all the monies tied up in inventories, and that has now changed, and stockpiles are going up again.

Do you communicate these decisions to the railroads ahead of time so that they can prepare to change their operations?

MR. LAFFERE: We do communicate on a

regular basis with the railroads. Per se we don't let them know when we are changing our inventory targets or levels, but what we do communicate -- and this is different for each utility, depending upon what their contract states or what their tariff might state.

But a normal provision would be that at least three to four months before the beginning of each year, we would give the railroad the tonnages that we expect to move on a monthly basis for the upcoming 12 month period. And within that you would have -- that would allow them to plan for the amount of coal that we are going to move.

At the same time, we talk with our railroad representatives on a regular basis, and we will talk about out-year projections, where we are going, whether we foresee any significant increases in the tonnages that we plan on shipping, even out three, four, five years from now.

COMMISSIONER MULVEY: So you have issued them the forecast that increase and act accordingly?

MR. LAFFERE: We have never not provided the railroad any information that they have asked

for related to the tons to be moved.

COMMISSIONER MULVEY: One of the things that railroads point out to us, is that many of the contracts that they have for moving coal are legacy contracts, which are 15, 20 years old. And during those times, there have been relatively small increases and sometimes no increases at all in the rates. Wouldn't you expect to see a substantial increase in rates after a 20 year period where the rates were flat?

MR. LAFFERE: It depends on the type of rate. Again, if it were a legacy rate -- and again, I am speaking just from my own knowledge. I can't speak for all contracts. But a significant number of contracts did have what are called adjustment factors related to the RCAF. So to the extent the railroads incurred increasing cost on an annual basis, those are being passed through annually through the rate adjustment. So when you get to the end of a period, no, I would not expect a significant increase in the rates.

COMMISSIONER MULVEY: I was at a conference awhile back, Monday actually, in Duluth where I was on a panel with the Association of American Railroads and CURE. I felt like the

voice of reason in the middle of a --

One of the things that the AAR pointed out was, with regard to electric utility rates, that since 1980 electric utility rates have gone up 30 or 40 percent in real terms, whereas the coal rate, the rate to the coal companies -- the utilities for hauling the coal, in real terms has gone down. So that is about 60 percent of what it was in real terms in 1980. Doesn't that argue that rates are down and they have been much more "reasonable" with regard to their customers than the electric companies have?

MR. LAFFERE: Again, any time that you want to get into a discussion about revenue or rates, I think that you also have to look at costs. And again, while I can't speak for all utilities, I can speak for mine. At Kansas City Power & Light, before last year our last rate case was in 1985. From 1985 through 2006 we had three rate decreases for our customers, and that was a natural function of our costs were going down every three to four years. The commissions would come in, they would go through our books, see what our costs were and then we would reduce our price.

So from a case standpoint, I can tell

you that is not the case. What is happening now, we are experiencing some increases as we -- we talked about it yesterday, at wind generation, as we invest in energy efficiency programs, as we build additional coal plants. But again, I think if you want to talk about price increases, you have to look at what the underlying costs are doing associated with that product.

COMMISSIONER MULVEY: Mr. Linderman.

MR. LINDERMAN: Mr. Mulvey, the thing that I would add here is, bear in mind what the AAR does not include in their cost of coal transportation. They don't include the cost of power generator's investment in loop track, in unloaders, in rail cars, and as you saw yesterday we have got a lot of money on the barrel that has been there. We are the ones that will have to add loop track to be able to accommodate 150 car trains if the railroads ever move to standardizing on that level, which I understand they are trying to.

The other thing from a strategic perspective that I would offer to you is, at least twice annually the C.E.O.'s of our industry, the C.E.O.'s of the coal industry and the C.E.O.'s of

the railroads all sit down together in a meeting room and talk. It is usually done under the egis of the Edison Electric Institute and our coal based generation stakeholder's group because of environmental issues that are common to the three, but they do sit down and talk. That's the time when the strategic issues and discussion does take place.

COMMISSIONER MULVEY: There was some discussion of the railroad's reliability. But the railroads have often claimed that the reliability problems, especially over the last couple of years, has not really been a railroad problem for the most part, but it has been more of a mine problem, as the mines have been unable to deliver the coal to the railroads. They have the trains sitting there waiting to be loaded, and the mine operations are just unable to do that, to get the cars loaded, the trains moving. It is more their problem than the railroad's problem. Would you agree with that?

MR. LAFFERE: No. I think that it is --

COMMISSIONER MULVEY: Quick, good answer.

MR. LAFFERE: Any time you put the blame

in any one direction, I would argue it is going to be incorrect. As someone mentioned earlier, and as the NCTA we have talked about, it is a three-legged stool, with each one dependent on the other. Are there problems with each one of those groups at times? Yes. There are times where the mines have problems, when they have floods in their pits, when the slough goes down in, when conveyors break down, that they are not able to fill the trains as they come in, that does happen.

Do the railroads have significant problems at times? The answer is yes. The service crisis of mid 2005. And I won't leave the utilities out. There are times when we have problems. Right now we have a stacker reclaimer that has structural issues with it, and so we are restricting the loading for six to eight weeks.

Can I tell you which part of that piece has the greatest impact? I can't say. Each one does have an impact, is an ongoing part of the business. And again, I think all of us as utilities, as railroads and as mines have to build our businesses to where we can handle those problems as they occur and recover from them.

COMMISSIONER MULVEY: Every industry of

course is going to have down time, is going to have equipment failures. That is expected. Industries like the railroads and the mines are going to be subject to weather problems. That needs to be factored in to anybody's planning and what they need in terms of stockpiles and what they feel to be reliable.

And reliability is not that you get every single delivery every time exactly, but you get everything that could be expected given the events of weather and other outages.

But when you said the railroad is unreliable or questioned the reliability of the railroads, what is the problem above and beyond these things that you normally would have expected in any operation that is similar to how a railroad operates? What are they doing wrong, in other words,

MR. LAFFERE: When you say what are they doing wrong. They are trying to supply an ever increasing demand. What I felt -- this is the Dave Laffere view of what was wrong in the 2003-2004 time frame, was that even though PRB demand was continuing to grow, even though the forecast from CANAC, from EIA, everyone else said

that demand was going to grow out of the PRB. Capital investments and crew manpower was actually reduced during that period of time, due to a short term slow down in that growth rate.

So when we tried to recover in 2004, there were problems associated with crews, there is problems associated with locomotive power, there is problems associated with track space. Then we were unfortunately hit with the derailments in 2005 which exacerbated the problem.

COMMISSIONER MULVEY: Mr. Linderman.

MR. LINDERMAN: The other part of that that I would note, Mr. Mulvey, is that we have got a situation in the country where we are being held to service standards, cycle times as I am told are not improving. I have checked in recent weeks. The AAR's transit times and speed times on their unit trains. And basically it is the same as it was in '04 and '05 with some degree of changes yet to be certain.

What that says to me is that in our industry where we have standards that we have to meet in terms of hertz and cycles and very technical standards of electric quality, where you can't take your electric -- the number of cycles

per minute that a generator is producing cannot deviate beyond a certain level without shorting out or burning up equipment, we find it difficult to understand why there can't be a greater set of standards that apply to the rail industry.

COMMISSIONER MULVEY: In your testimony, Dave, you talked about the reporting requirements and asking for the STB to have more reporting requirements with the railroad with regard to cycle times. Can you elaborate a little more on that?

MR. LAFFERE: Where I was heading with that, is that historically that was something we wouldn't have asked for from the STB, because it was handled in the contracts that were negotiated between the parties. Unfortunately with the public pricing tariffs that are coming out, most of those provisions are being gutted. So if we can't get commercially reasonable terms on a contractual basis, we are asking that the STB provide some resemblance of that. So we would be looking for, we talked about cycle time performance, some type of standard that the railroad should be able to perform to, and to the extent they don't, that there are some

compensation for that.

COMMISSIONER MULVEY: Mr. Linderman.

MR. LINDERMAN: I would agree with Dave's observations there. It is cycle time, it is contract terms, it has all become moved into a more transparent arena with the way the gas industry has moved over the last ten or fifteen years. The way the electric industry is moving. So that the public can understand what costs make up the components, and what it is paying for fuel and generation. The way in which we serve the public.

There is a -- one of the things that happened in the development of standards in the energy industry, was the Gas Industry Standards Board was formed about 15 or 20 years ago and helped the gas industry move through deregulation, with setting up bulletin boards, electronic bulletin boards, so that they could handle the release -- the capacity release on the pipelines for the use during the off season when the local distribution companies were not using gas full time in the summertime, that they could sell that capacity and make some money on that capacity that they didn't need at a given point in time. That

that was handled on an electronic bulletin board basis, so that people could bid on it that way.

It is those kinds of things that we see that are needed in the rail industry, is more transparency and understanding of what is available, capacity that is available. It doesn't mean more regulation, but it is opportunities to do better. To do business better.

COMMISSIONER MULVEY: That's it for now.

VICE CHAIRMAN BUTTREY: As I understand it, the power grid of this country is divided into two segments. It is the eastern segment and the western segment.

MR. LINDERMAN: Plus add in Texas. Texas falls as a third reliability region that is separate from the east and the west.

VICE CHAIRMAN BUTTREY: The outages are cured -- they cannot be cured across that border. They have to be cured by power generation and distribution systems in the east, or power distribution systems in the west. They cannot cross over that great divide, if you will.

MR. LINDERMAN: That's true.

VICE CHAIRMAN BUTTREY: That's the way it is currently set up.

MR. LINDERMAN: That's the way it is currently.

VICE CHAIRMAN BUTTREY: There are those who think that something should be done to make it possible for power to cross that great divide, so to speak, at two or three different points for obvious reasons. Is there any progress toward doing that?

MR. LINDERMAN: Mr. Buttrey, there is not any specific progress that I can point to towards doing that, but I would hasten to add that there are efforts underway in the great plain states to develop new high voltage transmission to take and move large amounts of wind generated electricity into eastern markets that are on the east side of the interconnection divide. So that as a way to help develop the wind industry in the country, as well as to meet in some cases state renewable portfolio standards, and in other cases to beef up the grid.

VICE CHAIRMAN BUTTREY: That capability, however, is limited by the fact that the voltage that can be produced is diminished the further it has to go.

MR. LINDERMAN: That's right. Now, we

do transfer large blocks of power in a -- there are two very strong direct current transmission lines in the country. One runs from the Washington Oregon border on the Columbia River southward to Los Angeles. Basically it is non-stop power, that is a 750 kilowatt direct current line. The other direct current line that I am aware of in the country is one that runs from the middle of North Dakota towards the Twin Cities that takes some of the excess power that is produced up there by Basin Electric and others down to the Twin Cities for that. And I'm sorry, I don't have the voltage figure on that in my head at this point.

We are in the process of struggling in Washington to -- one of the things that the Energy Policy Act did not do in '05, was it created a backstop arrangement by which the Federal Government can push the states towards the approval of new transmission lines which are called Energy Interest Corridors. It did not go as far as your authority in permitting railroads with providing eminent domain, nor as far as the Federal Energy Regulatory Commission has in eminent domain for gas pipelines, for interstate

service.

Assembling new transmission corridors is probably one of our most difficult challenges to building up the electric infrastructure in the country. Whether it be for transfer from electricity generated by new coal units, new wind units, or any other new generating technology that we would put in place.

VICE CHAIRMAN BUTTREY: Let me see if you would quarrel with this. The service requirements that you speak of that are on the utility companies, has a lot more to do with forcing the individual utility companies and distribution companies to provide the infrastructure for allowing voltage to run through their system by producing the gates that are required to let that happen, than they are with respect to any individual power company not being able to generate power for their customers in a particular locale or region. Do you quarrel with that? If you do quarrel with it, I would like to know why.

MR. LINDERMAN: I understand. I need to think about that one for just a second. The gates that we have -- and it goes back to the way the

industry was put together. Before we moved any interconnected grid system, each utility was an island unto itself, and it provided for -- and it had enough generating support where if it lost a generator, that it could cover that load that it had in its own territory. But that was, now it is close to 60 or 70 years ago.

And after we got out -- after the nation came out of World War II, we started to interconnect a little bit more, because people began to realize that there were some places where there was excess power being produced that could be sold or could be utilized. It developed first on the west coast, where people began to understand that the generation of hydroelectric power from the dams on the Columbia River provided a lot more power than the pacific northwest needed in the summertime, and could help meet the air conditioning load, the early penetration of air conditioning load in southern California. And hence the development of that corridor as a direct current corridor. The way in which that would -- those were to provide for gateways.

Today we are not -- we are building as much as we can. We are investing about $6 billion

this year in transmission for the nation. And that is primarily to beef up and upgrade so that we can operate and maintain our reliability at close to a 100 percent level, which is what most of us expect whether we are at home, when we plug something in or turn on a switch, we expect the power to be there.

VICE CHAIRMAN BUTTREY: Like a heart surgeon, you want him to be 100 percent reliable.

MR. LINDERMAN: Exactly. Like a heart surgeon or any medical practitioner, you want 100 percent cure. It is unacceptable not to have that. The other part of what is happening in the electric side, is that with the proliferation of more and more high tech devices that run on closer and closer edges to what we would term pure power, where there is very little voltage change and are very sensitive to those changes, it has become more incumbent upon us to beef up the grid. And that's why you see the billions of dollars in bulk distribution and transmission taking place at this point in time, sir.

VICE CHAIRMAN BUTTREY: I am just curious. We were out at the Hawthorn Plant yesterday. We talked about co-generation and the

need for having that capability, which you have at the Hawthorn Plant. You said that you were building a plant pretty soon, or it would be coming on line in the not too distant future.

MR. LAFFERE: We are in the process of building a plant at our Itan facility.

VICE CHAIRMAN BUTTREY: Right. It will come on line in --

MR. LAFFERE: 2010.

VICE CHAIRMAN BUTTREY: 2010. And I asked the question, will there be co-generation capability at that plant, and I think you said no.

MR. LAFFERE: No.

VICE CHAIRMAN BUTTREY: I don't understand why anybody would build a power plant, a power generating unit that didn't have some kind of backup co-generation facility, except for the fact that the grid allows for gates where you can take power off the grid and replace that power virtually on a moment's notice. Because you are sitting in a control room with 14 different screens in front of you, and you are monitoring that voltage literally 24 hours a day, seven days a week, 365 days a year without one moment's downtime, if you will, or not being monitored.

You have to do that. You absolutely have to do that.

MR. LAFFERE: Right.

VICE CHAIRMAN BUTTREY: If for some reason that the plant cannot generate that capacity, you simply go on the market, if you will, and take that power off the grid from other sources.

MR. LAFFERE: I guess I want to clarify. When you talk co-generation, I guess I am thinking dual fuel. That the plant would either be able to burn coal or gas is kind of the question you are asking.

VICE CHAIRMAN BUTTREY: Yeah.

MR. LAFFERE: Where to me, what a co-generation is, it is where you take a simple cycle combustion turbin, which has about a 13,000 heat rate, which means it takes 13 MCF of gas to generate one megawatt of electricity. You put a heat recovery system on the back of it, and because you are using that excess heat from your combustion turbine, now you can generate a megawatt of electricity with say 8 MCF of gas. So in the industry I think that is more of a term for co-generation that we would understand.

Why we would not build a dual fuel fired unit is several things. One, it is engineering. When you design a plant and we design the size of the boiler, that is dependent upon the type of fuel you are going to put into it, what the BTU characteristics are, what the moisture content is. And these are drastically different between bituminous coal, PRB coal and gas.

So if we take different designs, you would have to build redundancy. You would have to build it to handle whatever the lowest value was. You would also have to put in dual fuel systems into the boiler, to where you could either blow pulverized coal into it or you could put gas into it. Again, it is additional cost in the millions of dollars to have that dual capability.

But the biggest issue is the fuel itself. When you talk about having the ability to put natural gas into a boiler, on what day is that going to happen? Because when I go contract for gas transportation, I have to assume that I am going to need that natural gas on any day, in any hour across the entire course of the year. And so again, when we talk about a 900 megawatt coal fired unit, we would have to put in -- we would

burn roughly 90,000 MCF of gas an hour, which is a large quality. We would have to build a pipeline up to that plant that would probably be in the three or four foot diameter and would cost in the hundreds of millions of dollars to put in.

In addition, we would have to commit the firm capacity that we were going to utilize that and pay for it whether we used it or not. So again, we would be talking about tens of millions of dollars in additional annual operating cost for something that you might use once a year, twice a year or never at all.

So the question comes down to, is it more economical to invest in those pipeline assets and that transportation, or to rely on the electric transmission grid to be able to import power during periods when that unit might be off.

VICE CHAIRMAN BUTTREY: So that's what makes it possible for you not to have to do that, is the fact that you can pull power off the grid, either in the west or in the east?

MR. LAFFERE: That, and also our other generation. When you asked earlier -- for Kansas City Power & Light, again I am using hypothetical numbers. If our peak load is projected to be

3,000 megawatts this summer, we have to keep an additional -- we have to have all of that 3,000 within our system plus an additional 12 and a half percent. So we have to have 3,360 megawatts that we would have access to on any day during the year.

So we have a combination of coal units, gas units, oil units that in combination we could bring up, that if the grid was not there, if we could not buy power from someplace else, theoretically we could use all of our assets to meet our load. And as long as a unit outage wasn't more than that 12 and a half percent, we would still be able to meet our load even without having any interaction with the grid.

VICE CHAIRMAN BUTTREY: I think I heard you say just a few minutes ago in response a question from Commissioner Mulvey. Commissioner Mulvey asked you what you expected to happen to your rates for coal transportation once the contracts, the legacy contracts expired. And I think I heard you say you would not necessarily expect prices to go up.

MR. LAFFERE: There are two different questions.

VICE CHAIRMAN BUTTREY: Is that what you said?

MR. LAFFERE: You asked me what I expect when my contract comes up. I expect my rates to go up significantly because of the current market power. The question I thought he had asked was, shouldn't you expect that to happen, that once a legacy contract comes up, that you would expect rates to go up. And my answer is no.

Again, historically when you took into account that rates were adjusting through this RCAF factor, and when you took into consideration that the railroads were having productivity gains that were not part of the RCAF factor, their costs were going down. My rates were going up. So would I expect a significant rate increase at the end of the contract? And the answer would be no.

VICE CHAIRMAN BUTTREY: I just absolutely fail to understand the logic of that answer. I just don't understand that at all. A contract that has been in effect for years based on the prices that the railroads were charging at a time when they were suffering extremely low revenues, and a lot of them were in bankruptcy, to come out of a situation like that. It sort of

defies logic to me that prices wouldn't go up. Especially when you take into consideration the fact that based on the numbers I see, the average revenue per ton mile for coal is the lowest rate being paid.

MR. LAFFERE: But you have to take into account what is the cost associated with generating that revenue. And to me that is the part of this equation that is always missed and it is not discussed. We can talk about revenue is low. Yes, because these are the most efficient train moves that a railroad can handle. You basically put 133 cars in a circle on a superhighway and you let it run around. You are not taking up huge amounts of yard space, you are not taking up -- anyway. They are very efficient moves. So if you want to look at the revenue ton miles, that's fine. But take a look at the cost side as well, and then let's start talking margin.

Again, margin is where we can have a disagreement. If in statements that I have seen from the carriers, they are arguing that coal is not as profitable as some of their other moves. I think we have put into other hearings that you have had that we disagree with that. We feel and

our experts feel that coal is still a very profitable move for the railroads.

So if the profit margins are still there, if they can still generate not only their cost of service but a healthy return on it, then why should I expect my rate to go up 30, 40 or 50 percent simply because I have a legacy contract?

VICE CHAIRMAN BUTTREY: Did you say earlier in your -- I can't remember whether you said it or someone else said it, about the number of coal contracts. What is your -- what do you think your current percentage is of contract that you are getting right now currently for the PRB that is under contract, your percentage that is not under contract. Can you say that?

MR. LAFFERE: I would rather not get into those types of --

VICE CHAIRMAN BUTTREY: I was just curious. Commissioner, do you have any more questions?

COMMISSIONER MULVEY: I do. Somebody mentioned that the CNW was allowed into the Powder River Basin and that was a good thing in the sense that now we have more traffic out of the Powder River Basin than ever before and at more

competitive rates in some places.

There is another railroad that has proposed to go into the Powder River Basin, the DM&E. But the DM&E has had problems getting financing. And they have not been able to get utilities to step up to the plate and sign long-term contracts that would help them get the money in financial markets in order to do their expansion. If indeed there needs to be more competition on the Powder River Basin, why haven't the utilities, or for that matter the coal companies, stepped up to the plate and signed those contracts and given investors the indication that the DM&E would be a profitable venture if indeed its resources got built?

MR. LINDERMAN: Commissioner Mulvey, I would observe that there remains even today without the federal loan, there remains substantial interest from the electric industry in the DM&E. I am not privy to the term sheet that the DM&E may have circulated to our membership for what kinds of terms and conditions it would offer, but there is certainly -- one would have to think that there is going to be -- I am aware of the interest on Wall Street in the DM&E and of not

only domestic but foreign investors as well. It seems as though there may be an opportunity for the railroad to be built anyway.

I believe that the electric industry will take coal, it is a matter of staging, so that the companies can anticipate the time when that railroad may be likely to deliver coal into the marketplace and have it staged so that the company's contracts with either of the existing two carriers are nearing expiration, so they are not under contract with multiple carriers and providing -- paying for more coal than they need. That's what I am being told at this point in time.

In fact, I was on a call recently with the Dakota, Minnesota and Eastern leadership and they remain very committed to the project. As far as I know the electric industry is trying to move in that direction under a need to maintain our reliability of fuel supply at the same time.

COMMISSIONER MULVEY: It has been a long term project that has been more than ten years now since they begun this, and so far not a single potential user has signed a contract to allow them the opportunity to show the financial markets, "Hey, look, I am going to have customers for this

coal if I begin bringing it out."

MR. LAFFERE: I am going to speculate here, and to be honest I probably shouldn't. If I would look at my counsel right now, he would probably say, "Don't say anything." But as a utility you have to think about, you have an unbuilt railroad. It is like buying vaporware in the old I.T. side that we used to talk about. You know, you have two programs out there. You have one that is up and running, and you have one where the guy comes in and says it is going to do everything you want plus 35 other things.

So are you going to spend the money, put money into that project and bank on that for your business when there is nothing there? You indicated it has been ten years coming and it is still not going. Do I want to go out and sign a contract for the lifeblood of my company with something that doesn't have spikes in the ground? It doesn't have the permitting and the financing in place. And even if did I sign a contract, I would not allow that party to go wave it to Wall Street. Because if they were not able to perform and I had to get alternative service, I would not want whatever alternative options I might have

knowing that I have a contract with them. And again, I am speculating. I am not involved with the DM&E, but I would say there could be many reasons why you have not heard of contracts with shippers. They might be out there, they may not. I could say there is probably a lot of other work going on behind the scenes.

MR. LINDERMAN: That is the practical coal buyer speaking.

COMMISSIONER MULVEY: You talked about the -- you were talking about the railroad's costs and that that should be reflected in their rates. Isn't that sort of getting back to cost-based regulation? One of the parts -- one of the most important factors of Staggers was deregulating the rail industry. We moved from cost-based pricing to demand-based pricing. And demand-based pricing is when the pricing is based upon the electricity demand. Captive shippers having an inelastic demand, therefore you are going to be paying more.

The railroads don't really have much control over how much coal they produce or what they are going to produce based upon a whole lot of considerations. We don't regulate their inputs. The coal mines, for example, aren't

required to produce a certain amount of coal and the railroads are going to produce a certain amount of train supply based upon what they see to be the demand and how they are going to maximize profits. Isn't that sort of rational economic behavior on their part?

MR. LAFFERE: It is. But I don't think -- as I spoke earlier, I don't think when Staggers was enacted, that Congress envisioned having a duopoly in both the east and the west. It was expected that there would be active and vigorous competition among the rail carriers, and that would be the mechanism that would move us away from cost-based regulatory processes.

And again, I submit the argument that we are heading into a time where that system is becoming broken, and that there needs to be some -- at least a look at it and some measured response to that environment.

COMMISSIONER MULVEY: Well, to some extent we still have a cost-based regulatory process with regard to the stand-alone cost test for the railroads. That is cost based, in the sense that you look at what costs would have to be in order to operate a railroad to have a fair

return on investment. Are you critical of the Staggers process or do you think there should be some alternative to the stand-alone rail test?

MR. LAFFERE: We all agree it is complicated, that it is theoretical, that it is hard to get your hands around. But to date we don't know of anything better. I mean, it was posited through a process that took most of the 80's to come to agreement as to what it should be, with having the courts involved as well as the regulators and the shippers. Is there a better system? Probably. Is it going to be hard to come up with? The answer is yes.

COMMISSIONER MULVEY: We are trying.

MR. LAFFERE: I would like to throw a question back to you. I mean there is some speculation that at some point in the fairly near future competitive shippers are going to be paying rates higher than captive shippers. In a free market, in a market that doesn't have power, would you expect that to happen?

COMMISSIONER MULVEY: No, you wouldn't expect that to happen. And of course one of the issues, what is a competitive shipper and what is a captive shipper? A competitive shipper is one

that has an alternative. Competitive shippers, much of that traffic is not subject to our regulation. Of course, you might look and say, "Well, is that traffic as competitive for other modes of transportation as it was at the time of the preemption?" There may have been changes in the overall market and the availability of alternatives that may be allowing railroads now to raise rates in other markets.

Of course there is also value and service pricing. Some of the things that are being shipped are better able to bear higher cost increases. Obviously computers, for example, can bear a higher shipping cost than coal can. So there are a lot of other factors that might explain that.

Two other questions. One, right now there are no standards for mercury emission. Of course if you burn mercury -- Powder River Basin plants are particularly vulnerable to any changes in mercury emissions. What would that do to your plant here in Kansas City if indeed there was substantial increase in the requirement -- imposition of requirements with regard to mercury? Would you be able to rapidly invest so that you

could handle mercury?

MR. LAFFERE: We are trying to now. The question you posed, no, we can't meet the mercury standards that are being proposed out there today with today's technology. While we were at the plant yesterday, they were actually doing a test on mercury removal with a new compound. I can't get into any details, because I don't know them. We're actively pursuing ways to handle the mercury issue related to the PRB coal.

I would hope that at the end of the day if the technology does not exist to remove mercury from PRB, that the economy, that the politicians will understand that they are going to cripple the economy by switching to alternative fuel sources and there will be a rational decision made at that time.

COMMISSIONER MULVEY: There was also mention about the liability issue for moving things like anhydrous ammonia and others. As Doug was saying, when you move this sort of stuff you can bet the farm. Granted there was a serious accident, but the number of fatalities were relatively slow. Obviously an accident in a more populated area or a larger spill, et cetera, could

have much more dire consequences. Do you support -- and the railroads, while they self-insure, $25 million, it could be devastating on the railroad's survival.

Do you see any way of the shippers and the railroads partnering so that the railroads will not have to bear the risk of these accidents in moving things like chlorine, anhydrous ammonia and others?

MR. LINDERMAN: Mr. Mulvey, if I may, sir. The Price Anderson Act that was passed in the 80's is an indemnification on the electric industry, as I understand it, on nuclear issues. That may provide a template by which we can work with the carriers, or something can be worked out and taken to Congress jointly.

Certainly we understand that with prison terms as the ultimate price for exceeding your emissions, that our C.E.O.'s are not going to let -- their employees are not going to run their generation units out of environmental standards. That is simply a given. I don't think any of the several electric industry employees who are in the room would disagree with that.

That being said. We are trying to

figure out how we keep these systems running, how we permit the storage either on-site or in tank cars or whatever of anhydrous or aqueous ammonia, because we understand the liability concerns and the potential for human life as a loss factor as well. As I say, I would go back and look at the Price Anderson Act and the way in which your predecessor agency came to terms with the need to move nuclear waste as well.

COMMISSIONER MULVEY: Thank you very much.

VICE CHAIRMAN BUTTREY: Someone suggested that they take all the placards off their cars and just put a big target on the side, that way everybody would know exactly what it is. It would be a lot easier to identify those cars. Does Edison Electric have a position, as taking the position or made a proposal with regard to the hazardous materials liability limitation issue?

MR. LINDERMAN: We have not yet.

VICE CHAIRMAN BUTTREY: That sounds like you might be thinking about it.

MR. LAFFERE: We are thinking about it. We are open to discussions about it. I await call from AAR on it.

VICE CHAIRMAN BUTTREY: Thank you very much.

Now I think we are ready for Panel 4. Arkansas Electric Cooperative. Western Fuels Association. Dairyland Power Cooperative and Entergy Services, Inc.

Before we start this panel. I think what we decided up here, in the interests of time and everybody else's schedules, so you will know basically where we are headed. Maybe it will help you know where you are headed, if you are here from out of town. Given the fact that we have this panel and only one other panel after this on the schedule today, I think what we are planning to do is just power through this to the end. Not have a lunch break and just power through it and go on through this panel and the next panel and then the hearing will be concluded.

Having said that, we move usually from this area, this way to this way. So Mr. -- is it Rackers?

MR. RACKERS: It is Rackers.

VICE CHAIRMAN BUTTREY: I have the same problem with Buttrey and Buttery.

MR. RACKERS: In the old country I think

it was Rackers. Here in America we called it Rackers.

VICE CHAIRMAN BUTTREY: Anyway, Dennis, you may proceed.

MR. LAFFERE: Thank you. Good morning Vice Chairman Buttrey and Commissioner Mulvey. I want to join and ask you to extend sympathy from Dairyland Power Cooperative to Chairman Nottingham and his family in the untimely loss of his brother.

My name is Dennis Rackers, and for the last six years I have been Director of Procurement for Dairyland Power Cooperative in Lacross, Wisconsin. I am responsible for Dairyland's procurement and transportation of coal to its three coal fired plants in western Wisconsin. My career began in the 70's, and I have been involved in coal mining and power generation for over 30 years.

I am here today on behalf of 575,000 people that Dairyland serves in Minnesota, Wisconsin, Iowa and Illinois. We thank you for the opportunity to tell our real story and to participate in this hearing. Dairyland was formed in 1961 as a non-profit cooperative to provide

wholesale power to the area shown here on this map. Our mission is to provide competitively priced energy and services to our customers at maximum value to our owners consistent with the wise use of resources.

The electric industry is essentially comprised of three different models. Investor owned utilities, public and municipal owned utilities and member owned electric cooperatives. All are experiencing similar problems with service and rates for rail transportation of coal. Railroad personnel sometimes impugn the profit motive of the investor owned utilities, but all three business models provide power to customers at rates that are directly related to the cost of that power.

Despite the attention devoted to it, deregulated electric service has not advanced far in this country. The investor owned utilities have to pay a return to their stockholders, but the state public service commissions are very effective at regulating that return.

I recognize also that the railroads have to provide a satisfactory return to their owners, and I certainly don't begrudge them that. The new

rail pricing, however, the so-called Renaissance rates, are diverging widely from the cost of underlying rail movement, and the rates have lost nexus with the cost of that service.

But respectfully, it is your responsibility to regulate the railroads and protect the electric customers that they serve. Those electric customers are ultimately you and I and all the other families that pay the monthly electric bill. In addition to the size of the monthly electric bill, your decisions have a profound effect on the price of power and its broad impact on the nation's economy and competitiveness.

You already know that 80 percent of the nation's coal moves to its designations by rail, and that more than 50 percent of our electricity is generated with coal. The Energy Information Administration expects coal's share of generation to increase to 57 percent in 2030 despite the concerns about climate change.

More than 90 percent of Dairyland's power is produced with coal in its three electric generating plants. Dairyland uses 3.2 million tons annually. And about 2.3 million tons of that

is low sulfur coal from the Powder River Basin. Dairyland is one of the smallest or the smaller shippers of PRB coal and is probably the smallest electric generator in the room today.

Our Genoa and Alma plants were designed to burn Illinois coal, but for years they have blended PRB coal and bituminous coal to reduce sulfur dioxide emissions. Our Madgett plant is the only one that uses PRB coal exclusively.

All of our coal starts its journey on rail and about half of it moves the entire 1227 miles to the Madgett plant in Dairyland's rail cars on BSNF's northern corridor. The other half of the 3.2 million tons is delivered by barge to the Alma and Genoa plants. In recent years this half has been sourced from low sulfur western mines and has moved on the Union Pacific to East St. Louis where it transloads to barges.

Half of the barge coal or one quarter of our total travels 1,061 miles from the Powder River Basin in Wyoming, and the other half is Bituminous coal, it travels 1364 miles from Utah.

Here we see the BNSF corridor that travels from Powder River Basin to Madgett. Next is the Union Pacific route from the PRB to east

St. Louis. And then lastly the U.P. route from Utah to St. Louis. The last thing we see is the barge movement 500 miles to Genoa and 80 more miles to Alma. The upper Mississippi River is open to barge traffic only seven and a half months of the year.

At about 40 percent of the total, fuel is far and away our largest expense. Breaking it down further, transportation takes 71 cents of each dollar spent on fuel, while the mine takes 29 cents of that dollar. The railroad duopolists take much more from the coal than do the miners. Under the new Renaissance pricing, all but the closest plants pay much more for PRB coal than for the coal itself.

This graph has been prepared by Jamie Keller, a noted industry consultant that has addressed the Commission before, to depict new rail rates to competitively serve destinations. At the left side of the graph, the Burlington Northern Railroad was the only carrier in the Powder River Basin, and it was able to extract monopoly rates for PRB freight. Note the 18.7 mills per ton mile rate in 1983. But the Interstate Commerce Commission realized that

another origin carrier was important to promoting cost effective utilization of the region's tremendous low sulfur coal reserves. In the mid 80's it ordered BNSF to sell a 50 percent interest in its PRB track to the Chicago Northwestern Railroad and thus the joint line was formed.

The CNW partnered and subsequently merged with the Union Pacific to become a viable competitor to the B.N. As the U.P. and B.N. competed for market share in the next decade, they realized cost decreases through productivity improvements. Competitive rates dropped to as low as 7.3 mills per ton mile in 1993.

In the next decade railroad revenues increased as coal volume grew sharply, and profits increased as productivity improvements drove costs down. During this period of active competition, both railroads grew and improved their financial standing. Then early in the current decade BNSF realized that demand for PRB coal was about to outstrip the combined railroad capacity to ship it. In early 2003 it announced ambitious plans to increase rates with its 90068 Tariff. But the U.P. initially wasn't convinced that it would work.

In response to the BNSF announcement, U.P. said that it tries to increase rates roughly one percent every year, although it fell slightly short of that goal in 2002.

A year later, however, U.P. saw the light and announced its similar circular 111 Tariff in March of 2004. Both railroads realized that they would have to stop competition with the other if they were to achieve their dreams of dominance in rail pricing. They drove a stake into the heart of competition and it died at that time, in late '03 or early '04. Since then it has been a great time to be a railroad.

Shipper experiences suggests that the western carriers have clearly allocated existing markets and -- allocated the existing markets and customers between themselves. Now as contracts expire, even competitively served shippers struggle to get the other carrier to submit a proposal. If the non-incumbent railroad does submit a proposal, its rate is even higher than the staggering increase demanded by the incumbent railroad. Heller's work puts rates at 17 mills in 2006, but others report rates in the 19 and 20 mill range in private conversation. It is indeed

a great time to be a railroad.

Dairyland's experience with its western rail rates since 2001 is shown here overlaid with the same Heller data. These green bars on the right represent the average of Dairyland's three western coal rates. If you look closely, you will see a small decrease in the average rate in 2003. This coincided with the start of our new three year contracts. These contracts with the western carriers expired at the end of 2005 and our rates jumped 93 percent on January 1, 2006.

As a result, Dairyland's wholesale rates increased 20 percent, and the end use customer pays about $11 more each month on its bill. Only one of these movements is obstensively competitive, because the coal travels to the Mississippi River, both carriers provide that service. The rate for this so-called competitive movement lies between the other two rates as measured in mills per ton mile. When asked to submit a proposal in 2005, the non-incumbent carrier said it did not have the locomotives necessary to move this small 800,000 ton volume and refused to quote the coal movement.

In 2004 we were shorted 26 percent of

the coal under one of these contract movements. Dairyland suffered damages of $7 million to buy replacement coal from other sources. To continue shipments of this important source of low sulfur coal beyond the expiration of our contract in 2005, Dairyland was forced to abandon its claim of damages against that carrier. Our experience is not unique. Others have similar tales of woe, but it is indeed a great time to be a railroad.

The green portion of these bars shows the contribution of the fuel surcharge to Dairyland's new rates in '06 and '07. Fuel was included in the prior contract rates and there was no separate surcharge before 2006 for Dairyland. The fuel surcharges added 17.2 percent in '06 and 16 and a half percent year-to-date in '07 to Dairyland's underlying base rates. The AAR's latest RCAF basketed rail cost has fuel at 16 percent of total rail cost. Dairyland's based rates alone increased 69 percent in 2006, a multiple more than four times fuel's 16 percent contribution to the RCAF basket.

The huge fuel surcharge now paid by Dairyland, over and above the 69 increase to the base rates, is simply indefensible. This fuel

surcharge is simply another source of profit for the railroads disguised as cost recovery. Carriers are leaning on Renaissance shippers to pay the otherwise stranded high fuel cost for legacy shippers. It is indeed a very good time to be a railroad. Return to the two slides before, please.

Thank you for your attention to this story. My recommendations for remedial action are included in my written statement and I would be happy to respond to your questions later.

VICE CHAIRMAN BUTTREY: Thank you, sir. Mr. Herndon.

MR. HERNDON: Thank you. On behalf of the Entergy Services and Entergy Operating companies, I would like to thank the Board for holding this hearing and allowing those with a particular interest in this topic to address the Board regarding efficiency and reliability of transportation of the energy supply.

We agree with the Board's assessment that rail transportation is a vital link to the energy supply chain, which is crucial to this nation's economic stability and the national security. However, Entergy is not convinced that

the current rail transportation system provides a reliable and efficient mode of transportation. Entergy owns five coal fire generating units totaling just under 8900 megawatts of capacity. Through two of its operating companies, Entergy Arkansas and Entergy Gulf States, four of these units are located in Arkansas at the White Bluff and Independence station. The fifth unit is located in Louisiana at the Roy S. Nelson Steam Electric Station. All five units were designed for PRB coal, and with the exception of a few small test burns, exclusively burned Powder River Basin through 2005.

In 2007 shipments of coal from the PRB joint line are estimated to average one million tons a day. To meet this demand, 69 empties and 69 loaded trains per day are required to travel the joint line. This production supports a substantial part of total coal fire generation, which makes up about 50 percent of the total electrical generation in this country. Any chronic long-term significant loss of this coal fire generation could result in major electrical power shortages.

Even short term transportation

disruptions, depending on the number and frequency of those disruptions can affect how a utility views rail service reliability. These disruptions can lead to slower velocities on the railroad, increased derailments, increased use of force majeure declarations and the removal of service performance standards for the railroads. All of these events have the effect of reducing deliveries.

Based on data supplied by railroads and data supplied from Entergy's own experience, the rail transportation system is operating at slower speeds and the number of derailments are increasing.

The gross cycle time -- for all that don't know what grows cycle time, that is the total time it takes to make a complete cycle of loading a train, delivering it and bringing that train back to the mine. -- to energy plants have increased three to four percent each year since 2002. In Arkansas, the railroads have provided an additional three to five trains sets of their own equipment in order to meet our coal nominations. Cycle times haven't gone down, but they have added more equipment. Without the railroad's supply of

train sets, Arkansas coals would be subject to rapidly depleting levels.

At Nelson, current gross cycle time has resulted in delivery of only 85 percent of Entergy's nomination. In addition, according to railroad's own reporting data, we find continual decline in per quarter on time performance by both western railroads.

U.P. is also reporting that unit train speeds has declined by an average of 1.6 miles per hour between March 2006 and June 2007. Finally, based on data provided by the railroads to the Federal Railroad Administration, U.P. reports that the number of derailments caused by defective tracks increased by 1.5 percent per year between 1990 and 2006. Derailments involving Entergy supply trains increased on an average of six percent between 1995 and 2007.

Recent practice suggests that the railroads will be relying more heavily on the use of force majeure claims to excuse poor performance. From 1995 to 2004 the railroads made only eight force majeure claims to Entergy, for a total of 32 days. Since 2004, the number of force majeure claims have increased to 23 through May of

2007, for a total of 417 force majeure days claimed.

The greater reliance on force majeure claims further undermines the reliability of coal rail transportation services. It is also becoming evident from both the public pricing documents and other railroad pricing documents, that the western railroads are moving away from bilateral negotiated contracts between shippers and carriers and moving towards take it or leave it offerings. These new service documents contain little if any performance standards applicable to the railroad.

Based on Entergy's own data, there is a direct correlation between reduced performance standards and increased cycle times. At one of our plants, the cycle time that we were told to use for planning purposes following the expiration of the existing transportation agreement requires us to provide three additional train sets in addition to the four train sets already in service to deliver the same amount of coal.

If this same level of performance is applied across all customers taking PRB coal, train sets currently in service would have to increase by 75 percent in order to move the 360

million tons forecasted for 2007. This increase does not provide extra equipment capacity and thus would only add to more congestion and further denigration of transit times.

How do decreased performance standards result in greater efficiency? The answer is plain and simple. It doesn't. It is Entergy's belief that without outside influence, rail delivery of coal will become more unreliable and less efficient resources for utilities. Is there some influence that this Board can exert to keep the rail transportation energy sources reliable and efficient? We would like to suggest that the Board could provide greater oversight on railroad performance as relates to commodities critical to this nation's security.

This can be accomplished by developing specific performance matrixes that will provide board and shipper with early warning notices which will allow transportation issues to be addressed in their development in stages. These matrixes should be reported and made available to the public. To make any matrix valuable there needs to be accountability. There should be some benchmark established for these matrixes to allow

all stakeholders to identify when these performance levels are below an acceptable standard.

For example, it may be possible to identify system velocity levels that would warrant service review. Alternatively, service review could be triggered by matrix relating to train loadings or dwell time statistics.

Other measurements that could be developed could be in the following areas: Comparison of actual deliveries to requested deliveries. Unit train velocities. The number of unit trains or cars in service for a given commodity. The loadings or the number of traffic on primarily routes. The number of empties waiting for loads.

I have here, since the Board has a established the Energy Reliability Committee, Energy Advisory Committee, that committee could be charged with the responsibility of identifying and recommend measurements that would provide STB and energy market participants with valuable information without overburdensome to the railroads.

In conclusion, rail deliveries of coal

are an integral part of electric reliability. The adequacy of long-term coal delivery is fundamental to the cost effective operations of both power and electric systems. The development and implementation of robust reporting measures will allow for greater oversight of railroad performance. As stated earlier, railroads must be held accountable for some level of performance before the electric generating industry and other energy resources can rely on the service.

Thank you for your careful consideration to these comments.

VICE CHAIRMAN BUTTREY: Thank you, Mr. Herndon. Mr. Richards.

MR. RICHARDS: Vice Chairman Buttrey and Commissioner Mulvey, thank you for allowing us to comment today. I am going to make my comments brief today. I just did want to provide a few facts in terms of really our evaluation of performance. I do want to state up front that our inventories are not in crisis at any of the plants that we do serve today, just to let everybody know that.

I just want to say I am C.E.O. of Western Fuel Association. We are a natural fuel

supply cooperative. We are a not-for-profit entity. We buy and deliver coal for members who are typically G.N.T., generation transmission cooperatives. We were established in 1976. The original members were Basin Electric and Trising. I have got some logos here from our Class A. members. Our Class A. and B. members. We do buy and deliver the fuel for their power plants. We also have a number of Class A. members. We are not involved in buying and delivering the fuel for their plants. We do provide fuel services at their request at cost, so I am not here speaking on their behalf today. The gentleman to my left is one of those members.

We are in Denver, Colorado. We purchased in 2006, 17.3 million tons and delivered that to various power plants. We also are involved in associated mining operations. We manage a small operation in the Powder River Basin and in Colorado.

Just to get right to our rail service issues. I wanted to cover the cycle time information at several of the plants that we serve. There are seven plants that we provide coal to. The first one you are very familiar with

is the Limby River Station in Wheaton, Wyoming. This is the history of the cycle times starting in 2000. Within the cycle time guarantees we had under the contracts at that time, and obviously we have seen that go up significantly, surprisingly 2006 being worse than 2005.

It goes through the plants. We see the same thing at the Holcomb. This is in western Kansas. We have seen the cycle times go up there as well. It has not improved. Nearman near Kansas City, the same thing happened. Sherco is about a 750 mile movement to Minnesota. Again, we have seen cycle times go up and no change taking place even by 2007. Southeastern Missouri along about an 1100 mile haul, we have seen those cycle times increase as well.

The one plant we have in Quindaro, which is in Kansas City as well, we have sign cycle times go down. It is under what I don't want -- I wouldn't want to call a legacy contract, maybe that is a misnomer, I call it a competitively negotiated contract. And versus today where we have non-competitively negotiated contracts. We have terms in there that there are penalties for not meeting cycle time guarantee.

Going from that information to the increases that we have seen recently in the non-negotiated -- non-competitively negotiated contracts, we have seen rate increases of, this is as percentage of the previous rate, but at several plants being served by the railroads, we have seen the increase go up by 50 percent. And in Plant C., being the Larimer Station, nearly trippling since its original contract.

How does this happen where we are paying more money and our service hasn't improved? And I guess we see this as generally a lack of competition and probably maybe insufficient regulatory oversight. We would recommend, as others have already, that the Advisory Committee that you are going to organize, really look and try to address reliability issues. With that, I will close. And I am looking forward to some of the questions that have been asked before by previous shippers. I would like to have an opportunity to answer those as well.

VICE CHAIRMAN BUTTREY: Thank you, Mr. Richards. Mr. Sharp.

MR. SHARP: Vice Chairman Buttrey, Commissioner Mulvey. Good afternoon. And we

certainly pass on our condolences to Chairman Nottingham and his family for the loss of his brother.

As described in our written submission, AECC is keenly interested in the reliability of rail transportation. Three times in the past 14 years, and we have had ownership in power plants in Arkansas that burn Powder River Basin coal since the late 1970's. So we are looking at a 30 year history from our standpoint of shipping Powder River Basin coal to the state of Arkansas to produce electricity.

Up until 14 years ago we didn't have a situation where the failure to get coal to our power plant caused us to have to limit the electrical output of the plant. But 14 years ago up to today we have had three different instances where this has occurred, where failure by the railroads to deliver coal to our power plants has caused us to limit electrical generation out of that plant. And of course when that happens, we have got to get that electricity generation made up from some source. So we are either running natural gas plants or we are buying power off of the power market at substantially higher prices.

And in this most recent episode, which really for us is kind of continuing on today, I mean we are still incurring cost as a result of the rail problems that started in 2005. In addition to using natural gas and buying power off the spot market, off of the power market, we have turned to foreign coals as a way of trying to mitigate some of the additional cost that our members have to pay on their electric bills. And that, to a certain extent, that has been helpful.

Of course, having these kinds of restrictions where we are not able to run the plant like it was planned to run on the fuel it was planned to run, it is very disruptive to our operations. It dramatically affects our costs and what our members pay on their electric bills. It also causes produces distortions and adverse impacts that ripple through the economy in general.

The real good example of this is, like I said, I would say current crisis that we are really kind of still in that is ongoing from 2005. When that disruption began in May of 2005, we were pushed again to limit the output of our coal fire plants and pushed towards using more natural gas

generation. As that year progressed and this became a long term situation, or it became obvious that this was going to be a longer term situation, the Gulf Coast was also hit by Hurricane Rita and Katrina. So here are the utilities out there buying natural gas, which really is a supply and demand market, and driving up -- driving down the supply and driving up the cost of natural gas, which increased the difficulty and hardship that industries and individuals who depend on natural gas were suffering due to the hurricane situation. So there again, this doesn't happen in an isolated island, it is all interrelated with the economy and the competitiveness of American industries.

In addition to the reliability issues, we are also aware of the central role that efficiency improvements have historically played in the evolution of PRB coal transportation under the Staggers Act. For the past 27 years a long series of productivity improvements have benefited carriers and shippers alike, reducing costs, lowering the floor for competitive rates, and applying downward pressure on the cost factors that enter into these rate cases.

We just want to point out to the Board

that -- and it has been referred to a couple times here already by the speakers. The pivotal role that coal shippers have played in bringing about some of these efficiency improvements that have benefited the shippers as well as the carriers.

Expenditures by coal shippers and the mining companies in some cases on larger cars, aluminum cars, additions to loading and unloading trackage have been critical components of the increases in net tons per car and the net tons per train that the railroads are able to haul.

In addition, coal shippers and mines have invested in technological advancements such as automated car identification systems, automated precision unloading and loading systems. And we have also supported the efficiency improvements that the railroads were trying to achieve by allowing the railroads to redirect empty sets of cars in the PRB. Mr. Koraleski referred to this earlier. U.P. calls it a flip program. Like I said, it is no small thing for a shipper to basically give up control of his sets of cars that he owns and allow the railroads to put those in places other than where they were originally intended. But recognizing that that does improve

the overall efficiency of the system, many shippers have allowed the railroads to do that.

Also something that really hasn't been mentioned today, but something -- a program that the railroads undertook some time ago has certainly helped the efficiency of the overall flow of unit trains out of the PRB to the power plants, is the use of distributed power. But then also, there were also some things that the utilities had to do in that respect, by rearranging sets of cars and maintenance schedules. When you've got everything set up, your entire system set up on the length of trains being this long, and that gets changed, there are a lot of things that you have got to change. So there are a lot of cooperative efforts that are between shippers and producers that have helped.

It is not that the coal shippers have just been sitting back and harvesting the benefits of these improvements. We have done our share of the planning as well. We are quite familiar with rail efficiency and ways to achieve it, and we certainly hope that that is going to continue in the future.

In looking back at our experiences with

burn restrictions, we found a pattern that we believe provides some important guidance regarding the causes of rail reliability problems. Basically, before the last round of big rail mergers, the only time that we had to place a burn restriction on a plant, in other words, limit the electrical output of the plant, was when we had a very widespread flooding situation that disrupted rail service not unlike what happened here just a few weeks ago in the midwest part of the country. This was in 1993 and '94, and it was a little worse as far as the impact on the railroads, than the episode that we are just getting finished with, as far as flooding in the midwest.

Even at that time, the amount of coal that we had in inventory allowed us to pretty well ride through that without too many problems. Like I said, we did have to place burn restrictions on our plant, but it was for a very short period of time. There were some additional costs to us and our members, but it was tiny compared to what we have had since then.

Since that time we have had two much more serious episodes. The melt down after the U.P. S.P. merger and then these joint line

problems we have been referring to began in 2005. These episodes were huge in comparison to past natural disasters, and both appeared to have resulted directly from decisions made by rail management rather than any type of uncontrollable force.

To understand how this evolution came about, it is important to look back at what happened with the rail mergers and the so-called bottleneck cases. In a typical rail merger, the railroad would obtain an increased length of haul due to single line service, and they would achieve cost savings due to the elimination of redundant capacity. From the bottleneck cases, the railroads were able to insulate their longhaul moves against possible competition on portions of the route.

When you put longer hauls on fewer railroads, together with fewer options for competing carriers to step in when things go wrong, it is not really surprising that the rail system as a whole has tended to become less reliable. If something goes wrong with the performance of one or more of the railroads, it can really go wrong, because the market forces

that might otherwise mitigate the program have been constrained or eliminated. Excess capacity is scarce, and shippers have no practical way to separate a large railroad that may be working from the part that isn't.

In our written submission we discussed why it is important for the Board to maintain accountability by the railroads for their decisions and actions, and not just send the bill to shippers by pursuing a strategy that would rely solely on increased coal inventories to counteract unstable rail service.

We offer specific suggestions for action the Board could take to address the causes, rather than the symptoms, of railroad reliability problems. These include reconsidering the conditions imposed in past merger cases. Applying the competitive access remedies for poor service contemplated in the original bottleneck decision. And possibly changing the bottleneck criteria in light of changed circumstances.

In offering these suggestions, we would like to emphasize three things. First, we are not talking about any type of reregulation. That's a word that -- reregulation has been wagged about a

lot recently, and that simply doesn't apply to what we are proposing. What we are talking about is making measured use of market forces within the current scope of the Board's authority and discretion to counteract the problems that have been observed.

Second, we are not asserting that the Board made any error in the judgments that it made previously in these areas. What we are saying is, like in a case of collective rate making by motor carriers, the situation has changed, so that things that were found to be appropriate before are no longer appropriate now.

Third, in proposing these changes, we believe that there is a significant common interest between shippers and railroads. Probably none of the railroad witnesses here today would jump up and say, "You should get rid of the bottleneck criteria." They are not going to do that. Or nor would they say, "You should make more liberal use of competitive access." But, if they sit back and look at the situation and do the math, we believe that they will see that with the large and increasing volumes moving out of the PRB, the real value associated with operating

efficiency improvements is increasing. It was certainly valuable even back when you had excess capacity, but these efficiency improvements are going to be even more valuable now. And the wisdom of investing in capacity increases on efficient route segments is becoming more doubtful.

We believe our suggestions will benefit railroads in these areas. Of course we expect shippers will receive benefits as well. As volume increases, unleashing market forces becomes more of a win/win for railroads and shippers alike, as has already been experienced where market forces have been unleashed under the Staggers Act. We all saw what happened when that occurred.

I note that many shippers have expressed a concern and belief that physical opportunities for head-to-head rail competition no longer produce the vigor of competitive conduct that has been observed in the past. To the extent that such a reaction and competitive vigor has occurred, the Board may need to open the spigots of competition wider than it would have in the past in order to obtain the desired remedies. Appropriate use of market forces should provide a

physical way to address unreliability and the related problems that we have seen that arise. It should also create a climate that shields railroad management from undue pressure from the financial community for short term results.

I urge the Board to consider carefully the ways in which past actions individually and cumulatively may have contributed to the increasing volatility of rail service performance that has been observed, and to embrace the application of appropriate market forces as a remedy.

I appreciate this opportunity to participate in the Board's consideration of these issues and look forward to answering any questions that you may have.

VICE CHAIRMAN BUTTREY: Thank you, Mr. . Thank you to the whole panel. Commissioner.

COMMISSIONER MULVEY: In your written testimony you mentioned that three times in the past 14 years coal deliveries were below -- the coal shortages were severe, that caused you to have to reduce output. Were your stockpiles at that time 30 to 45 days as you see as a normal

level, or were your stockpiles at that time lesser than they are today?

MR. SHARP: I don't have those exact numbers with me, but the inventory targets were a little bit less than what the inventory targets have now been set at after this last meltdown with the joint line. This kind of gets back to something that was said before, that is totally wrong from my standpoint. We don't set our inventory targets based on what we think the coal price is going to be. The inventory targets -- the primary factor for setting inventory targets is the reliability of the rail transportation to the plant. If we had 100 percent reliable rail transportation to the plant, we would just put it on a conveyer into the burner and burn it. We wouldn't have a need for that additional cost.

COMMISSIONER MULVEY: I think it has been alleged that the utilities were operating much the same as the retail sector in the sense of trying to bring down inventories and free up resources so you don't carry such large inventories, and that that was part of the reason why any glitches in the supply of material from the PRB caused real shortages at the plant. I was

wondering to what extent there was truth to that argument?

MR. SHARP: I think if you look at our situation you would not find that correlation.

MR. RICHARDS: Can I add to that? I think it is important to point out a number of things with inventories in the past. It is another point of misinterpreting data, making wrong conclusions.

If you go back to the time when the PRB was just starting out, there wasn't a lot of production coming out of the PRB in the 1980's. The inventory targets that were set for a lot of utilities at that time, they were burning eastern coal or they were burning Illinois coal. It was barge coal. A lot of inventory targets, the river freezes up for six months of the year, and a lot of people at that time, the utility that I worked for, when I started working for them, they were selling off their barges because they were converting to PRB coal.

Prior to that time we had six months of coal on the ground to get through the wintertime. So if people use whatever year as a base and compare it with today, it is erroneous, because

those targets were set up for different reasons, and barges being one of them. It wasn't as reliable a system that it became when the Powder River Basin was developed.

The mines -- it is very difficult to build systems for the peaks. The mines have pit inventory to get them through the peaks, but they don't have -- it is too expensive to build a system to produce coal at the peak level, the railroads don't have the storage capacity for the peak level. The only place left to have the surge capacity to get through the peaks is really the stockpiles at the plants. The plants deal with the peaks, and the peaks go up and down as the demand changes, the load changes from hour to hour, minute to minute, it changes from season to season.

But we have to respond -- at the power plants, we have to respond to the peak. We have to provide electricity through those peaks. So that stockpile is always changing. The people -- we wear out equipment, we wear out people running that coal out to the stockpile and running it back into the plant. I mean we have -- in '93 there was the great flood, it was a 500 year, 1,000 year

flood. People had run their inventories down, they started running them back up. But it is really based on reliability. We are expected to handle the peak, and that's what sets the inventory policies.

COMMISSIONER MULVEY: Obviously if you run out of coal, the price you pay is very, very high, if you have brownouts and blackouts.

MR. RICHARDS: It is a real high price for me, because I get fired.

COMMISSIONER MULVEY: The question to you, then, Mr. Richards. You mentioned about the railroads cycle times going up. Why would the railroads not be concerned about reducing cycles times? It would seem to me that that would improve their capacity. You would have equipment turning around more quickly.

MR. RICHARDS: I don't know. I mean, they may be frustrated by it. I know they have made obviously additional investments in 2006 and on in 2007, and we haven't necessarily seen all that. So we don't know whether the capacity increase has been just to store more equipment on tracks, because it doesn't seem to have gone into increasing velocity. I know that's what their

goal is and that's what they would like to accomplish, but we haven't seen that yet. Is it crews? Is it locomotives?

I know there is some statements about the mines. We only started measuring delays at the mines recently. I don't know if that is normal. I don't know if it is exceptional. We don't have data that goes back to how many mine problems there were in 2000 or 1995. We don't have that base load data. I don't know if that is an anomaly in the data.

I don't know, I can't point to any one thing that I can see. Maybe when we get some of the cut-overs in this next section of track, maybe things will improve. We haven't seen it yet. And we do have -- we have -- out of 1300 cars we had several years ago, we have over 1700 cars today. So we have picked up 15, 20 percent more cars that we have had to go out and acquire for our membership to deliver the same amount of coal.

COMMISSIONER MULVEY: You indicated in your testimony also that you seem to be observing price signaling on the part of B.N. and U.P. Is that correct?

MR. RICHARDS: Well, when you have

public pricing -- you have price signaling taking place with the airlines when they publish their rates going from Washington, D.C. to Denver.

COMMISSIONER MULVEY: That's true.

MR. RICHARDS: In the airlines --

COMMISSIONER MULVEY: Do you argue that there not price competition in the airline industry today? I mean the prices are publicly put there, but there is obviously price competition in the airline industry.

MR. RICHARDS: Obviously not if you are flying from Minneapolis to Billings, you might not have the same competition. We like competition.

COMMISSIONER MULVEY: You mentioned defective tracks as being a problem. What do you mean by defective tracks? The railroad said they have been putting an awful lot of money into the Powder River Basin with double tracking, triple tracking and in some places quadruple tracking. There have been problems with the coal dust and the like. Are you suggesting that there was defective track due to inadequate maintenance or is it due to something else?

MR. HERNDON: The data was taken from the Federal Railroad Administration and it was

reported by the railroads as to what was the cause of derailments over time. There is a cause that is listed on the Federal Railroad Administration's website in accident reports that is defective track as the cause. And that is the data that was reported on there. I am not necessarily suggesting anything, other than the fact that that is, the defective -- the cause of derailments from defective track as reported by the railroad. And I think it does relate to the fact, that if you have increased track causes, that it has to have some reliance on track maintenance issues.

COMMISSIONER MULVEY: There has been some talk about diffusion of coal dust causing track problems. Is that something that you have been made aware of too, the diffusion of coal dust is a problem and it is causing the rights of way, the ballast and et cetera to get fouled and the tracks to fail more often? Is that something that you have seen, Mr. Richards.

MR. RICHARDS: I'm not involved in that litigation. Obviously we are working together through the NCTA to try to resolve the issue. First of all, we are looking at trying to study the causes and get a better handle on what the

causes are before we start addressing solutions. I guess that's where we are at. We are working -- hopefully we can work together to solve that.

COMMISSIONER MULVEY:

MR. RACKERS: Can I add. I'm not sure whether you understand the moment of levity here. You seem to be pointing your question first to Jeff Herndon. And Jeff Herndon's company is one that is being sued for trespass and nuisance of the dust.

COMMISSIONER MULVEY: I recall that. That's one of the reasons I switched. Go back to Dairyland. Over to Dairyland. You had a 93 percent increase in your rates in January of 2006. 93 percent over what time period, however?

MR. RACKERS: If I understand your question --

COMMISSIONER MULVEY: Was it over a one year period?

MR. RACKERS: It was from the expiration from our three year contracts.

COMMISSIONER MULVEY: A 93 percent increase from when the -- when was the rate established?

MR. RACKERS: It was three years before.

COMMISSIONER MULVEY: So it was --

MR. RACKERS: It was a three year contract. Rates were established in late 2002.

COMMISSIONER MULVEY: Did it also include the fuel surcharge?

MR. RACKERS: No, it did not. The contract rates did not include a fuel surcharge.

COMMISSIONER MULVEY: I thought in your discussion of the fuel surcharges, you were suggesting to some extent that the fuel surcharges were in the indexing of the rate, and then you were being charged a fuel surcharge on top of that, what you would call double dipping. Were you suggesting there was double dipping? I wasn't sure whether you were suggesting that or not.

MR. RACKERS: That's not what I was trying to say. I guess I was trying to say partly that, as I said, we had three year contracts that started in 2003 and went through 2005. And those contracts essentially compensated the railroads for the cost of fuel in the base rate. There was no fuel surcharge.

Starting in January 1 of 2006 our rates increased 93 percent over what we had been paying in the last year of the contract, which is 2005.

Our rates -- our base rates increased. The base rates excluding fuel surcharge increased 69 percent. The total rate, including fuel surcharge, increased 93 percent. My point was that the fuel, as a part of the RCAF basket of rail cost is 16 percent of the fuel cost. And our rate increase, base rates 69 percent. 69 percent divided by 16 percent is more than 4 times. So our base rates increased more than four times and four times the multiple of what is considered the fuel cost in the RCAF basket.

COMMISSIONER MULVEY: The major cost increase the railroads incurred. Did the STB recent rules on fuel surcharges help you?

MR. RACKERS: It has helped some, to the tune of about approaching a dollar and a half a ton on one of our movements.

COMMISSIONER MULVEY: My background is in economics. One of the things economists look at is this the game theory. Game theory always suggests that a duopoly is more likely to result in agreement on the duopolists then if you have triopoly. Does that suggest, therefore, that you are all in favor of the DM&E extension into the Powder River Basin and any of you are interested

in sort of ponying up and become guarantors of shipments out of the Powder River Basin by the DM&E?

MR. RACKERS: Yes, we certainly do support the DM&E and we are glad that you guys have seen fit to approve their application for the new railroad.

COMMISSIONER MULVEY: We don't really approve. We say that the -- we gave them 160 mitigation thing that they have to do in order to build the line, and then I think they can go ahead and build it. It is not our job to --

MR. RACKERS: I think one of the issues that I would be remiss if I didn't address with the DM&E. We saw from the graph what happened when the second railroad got access into the Powder River Basin, and we saw the effect of competition in driving rates down, all the time the railroads continued to prosper. Today it seems like the railroads are not competing. Once again, we have those very high rates in the 20 mill range.

Now, there is some thought that the DM&E could come into service and bring about a similar trend in rates. But I think one of the big

obstacles to the DM&E is the fact that they don't directly serve but a small number of coal fired plants. So many of the plants that obviously take coal today from the Powder River Basin are captive at the destination from the U.P. or the BNSF, and neither one of those railroads is willingly going to accept a hand-off or an interchange of trains from the DM&E.

COMMISSIONER MULVEY: Would the common carrier obligation, however, require that they accept an interchange? Or would the bottleneck --

MR. RICHARDS: Any bottleneck relief to the DM&E --

MR. RACKERS: That is a bottleneck issue. I suspect if the DM&E does succeed in its quest or commission to try to build a new railroad, that there are going to be shippers coming to you asking for bottleneck relief.

COMMISSIONER MULVEY: Because theoretically the DM&E would bring some coal out of the Powder River Basin that would increase capacity on the other lines. Once they both had more capacity, then they would begin bidding to fill that capacity and that would drive rates down.

MR. RACKERS: Theoretically, yes.

VICE CHAIRMAN BUTTREY: I just want to -- I didn't actually have a question for the group, but I did want to mention, because it hasn't been mentioned yet, and I think we actually try to do this at every hearing we have. We have this group at the Service Transportation Board which deals with consumer assistance issues. We have two members of that staff with us today who traveled out here for this hearing and to listen to what you all have to say.

For the most part, the avenues of approach for folks who are concerned about rail issues and how they affect them. You can either file a formal proceeding, or you can seek assistance through the Consumer Assistance Program with the Board. And I don't know that any of you have ever sought to use their expertise or not, but others have with admittedly varying results. But sometimes even with the exercise of your best efforts, you can't get a result that is going to make everybody happy. I never say you are not going to ever make everybody happy, but at least there is a shot that you might be able to get two parties actually speaking to each other. That is

certainly one of the things that they seek to do.

Other disputes, service issues and so forth, issues involving other rates -- not rates, but demurrage and other kinds of extraordinary charges like that are sometimes directed to that group, and they are able to actually get a resolution or get the parties talking to each other and get some resolution that is reasonably acceptable to both parties. At least for some period of time.

So I would just say that the service is there. It is available. All you need to do is avail yourself of it. And you can do that electronically. You can go on the web and through our website and access that service. They pride themselves on very quick response times to people who avail themselves of that service. They also pride themselves on being able to get in touch with the appropriate person at the specific carrier, whatever that carrier may be within a very short period of time. And I think certainly less than 24 hours, which is somewhat better than you would expect from our great government. But they do a very good job I think.

And I would suggest to the four of you

and anyone else in the audience, any other company or shipper in the audience that has a concern in that area, that you might want to avail yourselves of their services. Unless there are any other questions, we would --

COMMISSIONER MULVEY: I have one other question to Dairyland. That is, on the rail rate chart, the rail rate chart that you had with the increase. Was in real terms in mills per mile or nominal terms in mills per mile?

MR. RACKERS: It is my understanding that that is nominal cost prices.

COMMISSIONER MULVEY: Thank you. That's all.

VICE CHAIRMAN BUTTREY: We will excuse this panel and go to Panel 5 at this point.

Our next panel is Ethanex Energy, Inc. Mr. Rahm. And T.W. Blasingame Company, Inc., Thomas W. Blasingame. Gentlemen, thank you for being here. Welcome to the hearing. Mr. Rahm, you may begin.

MR. RAHM: Good morning Vice Chairman Buttrey and Commissioner Mulvey. We would also like to express our deepest sympathy to Chairman Nottingham and his family in their recent loss.

My name is Randy Rahm. I am the Chief Operating Officer of Ethanex Energy, Incorporated. Let me begin today by commending the Board on the undertaking of this hearing. Our nation's economy is dependent on many factors of production, upon which exists the growth and stability of the nation is based and concerned.

The most important of these factors is the regular and dependable supply of all forms of energy. I have submitted written comments into the record and will refrain from repeating them verbatim during this hearing. I do, however, want to touch on a few issues to highlight them and focus the Board's attention.

The use of ethanol is growing. Just in the United States ethanol has increased nearly 44 percent from 2004 to 2006, from 3.4 billion gallons to almost 4.9 billion gallons. This is being driven by two factors: The elimination of MTBE from gasoline and the growing demand from the flex fuel vehicles using the E-85 ethanol, an 85 percent ethanol and 15 percent gasoline fuel solution. These are real factors affecting demand today in the marketplace as ethanol production ramps up and consumption increases. This ethanol

consumption would easily triple or quadruple in the near term.

What does this mean in terms of our nation's energy supply and rail transportation required to service it? Well, this is a twofold question. First, what else is happening in the energy sector to make demands on the railroad industry. Second, what are the bottlenecks inhibiting the efficient movement of ethanol by rail today and what will they be in the future?

So what else is there? One big answer is coal. The AAR reports that coal comprises nearly 44 percent of the traffic moved by the railroads. This figure, due to numerous factors, will grow in the coming years as demand for electricity increases, and other fuel sources, such as natural gas and oil are becoming increasingly less cost competitive for electric generation.

For example, between 1990 and 2005 coal consumption increased nearly 25 percent. The railroads responded to this challenge by increasing capacity in the Powder River Basin. At the same time as this tremendous growth in the coal sector, there has been a sizeable growth in

the ethanol industry.

There are 125 facilities currently producing ethanol in the United States, with nearly six billion gallons total capacity. The industry is spread out across more than 20 states, with more facilities coming on line every year. In fact, nearly 80 facilities are currently under construction, and when these facilities come on line within the next two years, the industry will have grown nearly 44 percent. This means that the industry output will stand at nearly 8.5 billion gallons in 2009, up from 3.4 billion gallons in 2004.

Railroads move nearly 7.2 million tons of ethanol in 2006. Currently ethanol comprises just one percent of the railroad traffic. But if volume increases in the magnitude that is predicted by the EIA and industry professionals, ethanol could become one of the railroads top five commodities the next five to ten years.

With this in view, it is vital that everyone involved in the production of ethanol, the feed stock suppliers, co-product consumers, blending terminals and the railroads lay the best plans for the future of the industry.

Current and future bottlenecks. Feed stock suppliers have worked hard in recent years to adapt to unit train movements. Most farms now move their products to large grain elevators that are conducive to shipping unit trains, which differ in size depending on the railroad carrier.

As concerns about bottlenecks for feed stock suppliers, they are less concerned with operation, per se, of unit trains, but more concerned with availability of cars.

The use of unit trains have reduced the car availability problem for many grain shippers. This is important to the ethanol industry, because just as electric utilities require a stockpile of coal for continuous and smooth operations, ethanol producers require feed stock to be available when the production run is ready to begin.

The delivery of grain shipments must be predictable and reliable. Our concern is that as demand increases in the magnitude that I have noted, locations that once functioned without capacity restraints will become new bottlenecks. The time is now before the aggregate demand for grain grows, for the agricultural sector to begin planning to ensure an adequate supply of hopper

cars and infrastructure for the proper movement of feed stock.

New ethanol plants are being designed for unit train service, not only to receive unit train shipments of corn and other grains, but also to ship using unit trains. To this end, ethanol producers that have small facilities may have to expand infrastructure or collaborate with other plants to provide homogeneous unit train shipments to promote coordinated policing industry-wide function.

This is being facilitated by the railroads. BNSF promotes unit train shipments from smaller plants. At the same time larger producers must make the requisite investments in industry track and loading facilities.

The railroads for their part are to be commended for the attention and concern they have shown for the ethanol transportation. In recent years almost all the carriers have introduced some form of ethanol specific service. For example, BNSF Ethanol Express and CSX FX Unit Trains.

Still we feel this efficiency will be further improved as new methods and techniques are implemented. For example, unit train coal

shipments are off-loaded and turned around in four to six hours at electric power generation plants. While unit trains at ethanol destinations can take 24 to 36 hours.

As supporting origination and destination infrastructures develop, these matrix should improve markedly and thereby reducing costs and increasing efficiencies. The probability of new bottlenecks developing on the rail system is a real possibility, especially without a significant portion of the traffic moving in unit train service.

Potential bottlenecks could develop in rail yards, switch capacity, and terminal space could be restrained. These problems are foreseeable and can be addressed if the railroad has planned expansions of their systems proactively.

I do know that the railroad industry is making investments in key areas as I am sure they have pointed out. This is a great concern in the ethanol industry, that privately owned blending facilities are not up to par when it comes to handling unit train shipments. This is not directly their fault, but an historic event that

they must adapt to the new role of ethanol as a fuel.

For example, most terminals are limited to handling only three to five cars at a time. And even larger terminals can only spot 15 to 20 cars. Thus even with unit train operations, the destination terminals which use the ethanol are factor limiting productivity.

As an example, in the past few months, the BNSF has embargoed a terminal in New Jersey due to lack of highplate capacity. At the same time, the BNSF has embargoed cars in California terminal for lack of tank capacity. These bottlenecks at terminals will have to be addressed in the near future, especially if the use of E-85 expands, and the increase in ethanol use due to elimination of MTBE.

The changes in demand will cause and are causing a strain on existing terminal facilities. Existing terminals include such as cars in California, Seaward; New Jersey; Albany, New York; Arlington, Texas; and as I just heard Baltimore, Maryland, are going to have to step it up to the changing marketplace. New terminals like that are proposed in Stockton, California; Dallas, Texas;

Tampa, Florida; Dorryville, Georgia, and the Providence, Rhode Island that they just stated came on line, are going to have to plan proactively for the new -- developing new transportation paradigm.

I would also like to note that some shippers concern about ethanol transportation are misdirected at the railroads. For example, in the July 17th, 2007 issue of Progressive Rail Daily News, the president of Iowa Northern Railroad, Dan Seven states, and I quote, "Most of the blenders were designed to receive commodities by pipeline or water vessel. And most of them are landlocked," he says. "Until receivers of ethanol can handle large blocks of cars or full unit trains, the single car moves will have the effect of choking the rail system. If Congress would provide incentives for railroads, including short lines and regions to build rail to truck terminals in consumption regions, tremendous efficiencies will result and the flow of product will improve dramatically."

In closing, there must be a cooperative and collaborative spirit between feed stock providers to harmonize a service within this

industry. Ethanol producers must build facilities with unit train capabilities that are efficient and respond to the efficient railroad transporation requirements.

Railroads must anticipate proactively the future expansion of the ethanol industry and be ready to provide fast and efficient service. The blending and refining terminals must expand and enhance their facilities to the realities of the expanding ethanol presence. The mutual beneficial relationship can only be created with careful planning and foresight. This proceeding is a good step in that direction. Thank you.

COMMISSIONER MULVEY: Thank you, sir. Mr. Blasingame, thanks for coming.

MR. BLASINGAME: My name is Tom Blasingame. I am with T.W. Blasingame Company of Boise, Idaho. We are equipment designers. My background is that for ten years I was running plants production projects for Morrison Knudson Company. As time went on, we set up our own company in 1979 to do independent work for M.K. and other large contractors.

Our work was developing concrete lift lines for power plants. We did special equipment

design for those people. And over the years we did locomotive drawings for their Boise and Sirillian operations. So we gained a background in locomotive construction and design in those years.

The reason I am here today is to introduce you to the 800 pound guerrilla in the room. That guerrilla is the fact that the total transportation of coal in this country, the production of coal and the distribution of coal is totally dependent on diesel fuel. As you know, this country has no borders that are protected. No one is controlling anyone that wants to come in here. Anyone that doesn't like the way this country operates can shut it down in less than a week's time by destroying the petroleum industry. The petroleum industry in this country, which requires crude oil from foreign and domestic sources.

About a month ago I had the pleasure of making the acquaintance of a gentleman who was in the military. He said that he was in Bosnia. His first operational priority was to destroy the opposing military aircraft capability of the enemy. The second priority was to destroy the

petroleum refining capability of that country. So I can tell you, that if you want to lose sleep at night and wonder how your coal is going to be delivered to your power plant, you need to wonder how those 750 trains that leave the Powder River Basin every week each with 115 cars, each car with over 100 tons of coal, how they are going to move without diesel fuel. I just want to bring that up to you because I think it deserves some consideration since we are talking about how we are going to meet the energy requirements of this country. To me, this is a strategic vulnerability of the coal transportation industry in this country.

In the 17 years that we have been working on this project, we have designed several locomotive types. There are two types. One is a medium range locomotive. One is a long range locomotive. And of those two types, we have several different categories. We can run on gaseous fuel, we can run on liquid fuel, we can run on solid fuel. The solid fuel is by far the cost effective. That includes coal, it includes cubed condensified fuel cubes made from what goes in the landfills. And it can work -- we can run

these locomotive on shell corn if you want, or on corn husks that are condensified.

So I am just giving you today an alternative means of transporting your coal trains. That is not to say that you are going to see it in the next ten years. The diesel locomotive was highly refined in the last 50 years, however it is very picky on the type of fuel it likes to run on. So far they have not been able to make these diesels run on coal. Although there is an attempt to make coal into diesel fuel, that is going to be about $4.00 a gallon. So if you don't like the price you pay now for transportation, you can look forward to paying -- the railroads to haul it with $4.00 a gallon diesel fuel.

Our cost studies are based on a 577 mile trip over the Ritan pass on the old Atchison Topeka and Sante Fe Railroad. We use that cost scenario to determine the costs on any particular fuel. And when we talk about running on $45 a ton coal, we are able to run it about one third the cost of running on diesel fuel. When we talk about running on Powder River Basin coal, which ranges from 8300 BTU's per pound to 8800 BTU's per

pound, has 27 percent moisture, then we are able to run it about 25 percent the cost of diesel fuel.

Now the question is going to be, does the bottom line really get to be the bottom line? What interest does the railroad have in using coal fired equipment. I can tell you that today there is zero interest on the part of any major railroad in using anything besides diesel fuel. They have a major investment in diesel power. They have got a major investment in the fueling facilities. But I can guarantee you that without diesel fuels those locomotive are not going to turn a wheel. So it deserves some consideration.

The reasons that the railroads don't want to go back to coal are obvious. In the first place they don't have anyone left on the roster that knows anything about coal fired locomotives. That doesn't make any difference, because what we have is totally different than what was available 50 years ago.

For instance, in the old days the reciprocating steam locomotive was a high speed machine built on a bicycle theory. And its starting track was about one third the modern

diesel locomotive. Today our locomotive proposals include all-wheel drive, electric traction motors on all the axles. Our tractive effort is the same as for diesel power. We don't have anywhere near the amount of horsepower per axle that they have on 6,000 horsepower diesel locomotives. On the other hand, we don't ripple up the rail and you don't have to grind the rail.

There are some other aspects of our power that are different than they were 50 years ago. One is when the railroads fueled these locomotives in the old days they used overhead fueling facilities, dumped the coal in the top of the tender. If the coal blew out, that was fine. Today our locomotives have bunker doors that cover the coal bunkers. You are not going to have any coal dust going down on your roadbed to mess up the drainage in the roadbed.

We have completely gone through the power delivery system. You have to understand that a 9,000 horsepower steam electric locomotive basically will put out about 4.6 megawatts of power. We are basically a mobile power generating plant. So these locomotives can be run in multiple with a diesel electric consist. If

you've got a diesel locomotive that you want to run with it, that is possible.

The computer controls on a modern diesel locomotive can tell you anything you want to know about the maintenance on that locomotive. The same technology that is used there can be used on these same locomotives.

I can tell you that in the 17 years we have been involved in this process, in this project, we have learned a terrific amount of information about how to run coal cleanly and efficiently. One of the things we learned was that we can take steam and split it into oxygen and hydrogen. We can feed that into the fire box to make sure we can burn anything in the fire box that would burn. Anything that would not burn would go through the boiler and come out the other end where we have an ionic scrubber to take everything out that doesn't burn. So these are clean green machines.

Today we brought a few of our little green brochures. I hope that all of you will take one of those. We also brought some color renderings of some of the locomotives. Since I screwed up your lunch hour, I suggest you might

want to invest another five minutes after I am done with this presentation to take a look at these locomotives. I guarantee you that they probably won't scare you to death. They look a lot like a diesel electric locomotive. We even have a little air horn on front to make proud. We also have a steam whistle on top to make you think we know what we're doing.

I just want to encourage you to think outside the box. And remember that for 150 years in this country, the coal fired locomotive did everything we asked it to do. It burned the lousiest fuel you give it, and it did a good job. Unfortunately technology overran it. We're here to see that that same thing happens again. So I would like to invite you to take a look at this little brochure and these color pictures that we brought with us. If you have any questions, I would like to answer them at this time.

VICE CHAIRMAN BUTTREY: Commissioner.

COMMISSIONER MULVEY: I will start with Mr. Rahm. I understand that you have been involved in this coal dust suppression issue and you recently were on committee. Could you summarize what you found on that?

MR. RAHM: I will give you a little bit of my background. I worked in the Powder River Basin for ten years for Amax Coal at the Bellaire and Eagle Butte Mine. Most recently I was the director of fuels for Westar Energy, which we had over 2,000 rail cars and handled about 13 and a half million tons annually from the Powder River Basin.

And I was the chairman of the spraying committee for the coal dust investigation that the BNSF and the NCTA had begun. It was probably in the fall of 2005. And they set up a spraying committee and a grooming committee and then a railcar maintenance committee that looked at the railcar, the structure of the railcar.

We came about -- the BNSF had started these tests back in 2004 and prior to 2005. Even on the trip that we went on, with Matt Rose had talked about the rail dust issues and additional maintenance on the tracks. Those tests were ongoing at that time.

The BNSF had hired several consulting firms to take data, measure trains. They put diapers on the bottom of trains. They had an extensive amount of data that they collected

throughout this several years of testing that they had done. And they presented it to the NCTA for their findings. It was pretty evident that there was coal coming out of the cars due to gaps. There was coal coming off -- a significant amount of coal coming off the cars. They initiated the grooming, which had a very good impact on reducing the dust, but it didn't get all of it. The railroads are looking for a 95 percent containment.

From the tests they did with the encrusting agents, the only thing that got them to that point was spraying this encrusting agent. The tests were between 10 and 15 gallons per car. I read some of the recent articles where they mentioned 10 cents to 30 cents per ton. And it was never mentioned in any of the meetings that I attended, a price per ton. It was always mentioned dollars per car, because it is easier to calculate. They achieved their 95 percent consistently on temporary systems.

When I worked at Amax I was also involved with our coal drying facility at the Bellaire mine for a number of years. We used a car topper on the dry coal because it was so light

and fluffy. You lose 5 or 10 tons per car going down the railroad. So we always treated it with a topper. And the company had also done, for a utility in Texas, they had done some car topping with them. They put a two-inch crust on top of the railcar, and they did that for several years out of the Bellaire and Eagle Butte mine. That worked real well. It basically kept the coal in the car, as dusty as it was, when it was loaded. So when they turn the car over, this encrusting agent slid off and the coal was basically in the same state as it was when it was loaded, which is a benefit to the utilities.

What we see in the ballast, what proved in the ballast -- and one of the things about the Powder River Basin, is when they undercut the ballast, they are taking the ballast, as I see it from the pictures, just to the bottom of the tie. So if you have all this coal dust that is embedded in there, and when they go through and they are shaking and cutting, that coal dust is still filtering down in on top of this sub-base and filling up the sub-ballast, and then on top of the structural fill that they put in.

Now, unless that fill was brought in

from someplace other than Wyoming, it probably has a high content of bentonite. And bentonite as you know expands when water hits it. That's why it is so important to keep the drainage on the ballast, so the water drains away from the rails, it doesn't saturate down into the ballast. Because when it hits that -- if the water sits on top of that bentonite, that soil is going to start to expand and they will lose their structural integrity. That's when they have those open rail derailments because of the saturated area.

I have talked to some of the people recently that have done some of these, the new track that they put in, and it is already being fouled with a significant amount of coal dust. The railroads have showed pictures, where there is 100,000 tons of coal along the eastern side of the railroad in rows, so they have to get up on four feet of coal and drive along the tracks.

So not only is it a problem out there with the reliability of the railroad service in the Powder River Basin, that Powder River Basin, as some of my former colleagues have stated, it is the busiest corridor in the world as far as railroad track. It is also very fragile. When

that May 15th derailment happened, there was 300 parked railcars, trains from here to Memphis. It just obliterated. One of the things as a coal buyer, one of your job requirements, if you want to keep your job, you don't run out of coal.

Prior to 2005, that was a pretty easy thing to manage was your inventory. You never saw the chief executive officer come by your office and talk to you and ask you almost on a daily basis, What is your coal status? Having to produce daily charts, when you did them on a monthly basis, Where is your coal inventories?

As you stated, you asked about the inventories. You are correct. I have watched inventories across the United States with PRB coal that sample different utilities, and there was a 30 and 40 day inventories on a national average, and they gradually started going down. Why? Because they looked at the cost of carrying. And the efficiencies of the railroad at that time, they were delivering their inventories in the time frame, so the utilities made the conscious decision to start dropping the inventories. When they dropped the inventories, and then they got caught. Now they are caught at the 30 days or 40

days, where previous times they were up to 60 and 90 days because they had the reliability and they didn't want to carry it. Now they have got it down, and when that happened in May, the inventories were low and service went to pot for six or eight months because of all the track work and the cleaning that was going on.

So in order to take the focus off that, the only way you can do for increased cycle times was add sets. At that time the railcar manufacturers, they were out a year building coal cars, you couldn't get any sets. There was no sets available for that year period. Now from what I hear, I have been out of it a little bit, that sets are now being parked.

Service has improved somewhat, but you don't have that glut of sets causing additional congestion. And a lot of railroads were declining to take additional railcars or sets because of the congestion. They just couldn't keep them on the tracks. They were making the situation worse.

So when you look at the cost of spraying versus the ramifications -- say you had a 10 million ton plant. The ramifications, if you are paying a 10 to 15 cent or somebody said 12

cents -- or 12 dollars a car, and you are bringing in 100 million tons -- say it is a million dollars annually the costs that you are going to have to incur. So as a utility, you don't lose 35 to 50 million dollars, one, because of the D. rating that you heard these other gentlemen testify about for coal conservation, and for the lost margin opportunity, because you didn't have the coal to participate in the market when there is market opportunities.

So those are real dollars that these utilities saved. It is almost like an insurance policy for a utility to spend that money. I don't know how exactly they are going to implement this. But the reliability of the railroad is based on the condition of the track. If they have to go out there and undercut two or three times more than they do with regular rail, it is going to slow down the traffic. Just like now in the summer, they are doing the track work up there. Cycle times have increased because of the slow work. In the fall traditionally the cycle times will start to decrease as performance continues to improve as the track work moves out.

But if you are doing this annually,

every summer you are cutting, you are going to have a problem with slower cycle times and the utilities won't get the coal.

VICE CHAIRMAN BUTTREY: I appreciate your answer. Thank you very much.

COMMISSIONER MULVEY: I have a question on ethanol for a moment. There is a lot of literature out there that would suggest that ethanol, especially corn based ethanol, may not be the solution. All these plans are being developed and et cetera, but it may not be competitive with ethanol produced by other means, switch grasses or sugarcane from Brazil, et cetera.

Moreover, pulling corn out of the food and feed chains and raising the price from everything from corn flakes to the price of a decent steak maybe very, very hard a price and it may not be something that is sustainable. Much of the literature I read also suggests that other kinds of woody plants may be much better ways to go than going with corn based ethanol.

Do you think that -- there is quite a bit of literature that also suggests that the calculations surrounding corn based ethanol show that not all the costs are taken into account when

they do the analysis. When do you a full course analysis of ethanol, it shows to be that it costs more to produce a gal of ethanol than it saves in gasoline. Would you like to comment on those criticisms?

MR. RAHM: That is spoken from a true oil producer.

COMMISSIONER MULVEY: These come from people who are not oil producers, but other kinds of alternative energy sources such as wood based fibers, cellulose.

MR. RAHM: If anybody had a chance to see that 20/20, the last three minutes of that one night they had on ethanol. That was done by a study group that is 80 percent funded by Exxon.

COMMISSIONER MULVEY: Which one is that, is that Cornell?

MR. RAHM: It is a four letter acronym. Those guys were -- they are putting out this anti-ethanol, because the biggest opposer to ethanol is the oil companies. Because eventually as these states mandate E-85, just as Brazil did to get their oil independence from foreign oil, it is going to affect the oil companies. The oil companies aren't participating in the building or

the production of ethanol, so it is a competitor to the oil companies.

Now, when you go to a gas station that is a non-oil company gas station, ethanol will be on the pumps, right there at the aisle. If you go to a gas station that is run by a major oil company, they make them put the ethanol pump off to the side, out of the way, because they say the customers might get confused with it. Well, it is a big yellow handle, a big yellow sign. It is like putting diesel, they have got diesel up there. It is no different than diesel and gasoline.

Going back to your original question. On cellulosic ethanol. We are looking at -- the corn base in the United States can probably handle up to about 15 billion gallons. Anything over that is going to have to go cellulosic. There is enough crop land out there. If you look at the increase in corn acres. We are looking at a bumper crop in corn. Three years ago the farmer received $22 billion for their corn crop. This year they are going to receive $40 billion. And the price of corn back then was around $2. Right now it is about $3.34. It bid up to 4.40. It

fluctuates like any other commodity.

But the impact on corn flakes and stuff are cents. I mean, less than ten cents a box when you look at the overall, because of the fluctuation in the amount of corn that is used in there.

The big impact is the efficient utilization of the corn kernel. Our company, say 90 percent of the -- or 100 percent of the ethanol plants out there today are taking the corn kernel, they put it in hammer mills and they grind it up and put it in their fermenters. If you are looking at Brazil, they already have sugar. They don't have to convert the starch to sugar. They have a 20 percent advantage on cost.

What our company is doing, you are talking about technologies going forward. Our plants, and we are actually marketing this to the existing plants. We have a fractionation technology, where we take and we take the corn kernel, we take the bran off the kernel. It is the hull, the skin. Take that off the kernel. We take the germ, which is the brown part on the bottom. We take that off and we send the pure endosperm into the fermentation. So what you get

is you get 17 to 20 percent less fiber, because those enzymes have to work on the fiber. And you increase that 17 percent with more endosperm. So you get almost a 20 percent additional through-put of ethanol.

So if you have -- our plants are typically 108 million gallon name plate. We will be pushing 125.7 million gallons through those plants just by removing that, those two elements, the germ and the corn -- or the bran. Then we take the bran, and we have a biomass boiler and we burn the bran in the boiler that is almost 8,000 BTU's. We take the germ, we run it through a screw press, we get corn oil, which is selling at $600 a ton right now. We take the germ peg that is left over and we burn it in. So we have almost 90 percent of our energy requirements off of corn. So as they say, we are getting everything out of the corn kernel except for the squeal.

Also, you can take -- with the feed from the DDG, the distiller's grain that is left over. You heard somebody talk about the cattle market. We are not going to the cattle market. That is a 28 percent protein. By taking out the germ, which is the fat in the DDG, it increases the protein

level to 50 percent, which at that time makes it for the hog and swine and poultry markets which are being serviced now by soybeans. With the price of soybean, now you can come in there and compete with the soybean meal that is feeding those two entities.

So we are actually developing a new market for DDG, and we were not going to be over there flooding the cattle market as the other traditional ethanol plants. So also when we take our fractionation technology, we will go to other plants and we can just hook it right into theirs, and they can see the same benefits with minimal modifications within the ethanol process. And they'll get, depending on -- they'll get up to 20 percent increase in through-put of ethanol off the same -- more corn, but less cost. The energy costs are 20 percent less, because you are not drying as much DDG. You will have 15 percent less water that you are using, and ethanol plants are traditionally -- you are looking at three gallons, 3.8 gallons per gallon of ethanol that is produced. But the energy as far as that goes, if you did the side-by-side example of what it takes to make a gallon of gas, you will see that ethanol

is far superior, far less cost than it would be the cost of a gallon of gas.

COMMISSIONER MULVEY: Thank you. Mr. Blasingame. One question to you. I enjoyed very much the fact that you were included. Many of the letters that you had sent to the FRA, Amtrak and others about your idea and the reaction that you got. Why do you think that it has been so negative?

MR. BLASINGAME: I think that they just don't understand the power business. You can use coal because it is the cheapest fuel there is on a BTU basis. Apparently the railroads haven't figured that out yet, because if they had figured it out, they would go back and look at the records from the Norfolk and Western. The Norfolk and Western compared the BTU use on a reciprocating steam locomotive against the BTU usage in a diesel electric locomotive. That's why they justified the use of the steam locomotives they had longer than anybody else in the country.

The only reason they changed is because they got a new president who wanted to be a modern up-to-date railroad, and he couldn't do it with steam power. They designed and built the John

Henry, which was 4500 horsepower on 12 axles. And because it was only 4500 horsepower versus -- more horsepower for the steam locomotives than the diesels, it didn't travel as fast, but they got 20 percent fuel savings on their locomotive, based on their steam locomotives, which were side by side on an equal basis with diesel power at the time.

The other reason is that the railroads would like to haul coal for the customer and not for themselves. Okay. If they can convince the power industry to spend the money for the catdury to put over the railroad, and have the government participate in it, they would do it in a minute, because what they would really like to do is run electric trains. They are Lionel boys at heart and American Flyer boys at heart. When they grew, up their nose was against the glass of the Walgreen Drug Store, and they watched these trains go around in circles. No servicing required. No fueling required. What they don't realize is, that if a power plant runs out of fuel, there is a brown out. If it gets blown up, the whole railroad stops. That's okay, as long as you don't have to pay the bill.

COMMISSIONER MULVEY: R.L. Banks before

he passed away talked about the re-electrification of America's railroads. There are a lot of alternatives out there. Thank you, that's all my questions.

VICE CHAIRMAN BUTTREY: Thank you, sir. That concludes our hearing. Thank you very much.

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C E R T I F I C A T E

I, JAMES A. LEACOCK, Certified Court Reporter, do hereby certify that I appeared at the time and place hereinbefore set forth; I took down in shorthand the entire proceedings had at said time and place, and the foregoing 213 pages constitute a true, correct and complete transcript of my said shorthand notes.

Certified to this 30th day of July, 2007.

James A. Leacock

James A. Leacock, CCR.

Certified Court Reporter No. 662 (G)

Notary Public, State of Missouri