4301 Wilson Boulevard
Arlington, VA 22203-1860
Telephone: (703) 907-5500
www.nreca.coop

BEFORE THE

House Committee on Transportation & Infrastructure

Subcommittee on Railroads

Rail Competition and Service

TESTIMONY OF

Glenn English, C.E.O.
National Rural Electric Cooperative Association

4301 Wilson Boulevard
Arlington, Virginia 22203

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11:00 a.m.
2167 Rayburn House Office Building

Mr. Chairman and Members of the Committee:

My name is Glenn English. I am the Chief Executive Officer of the National Rural Electric Cooperative Association. I also serve as Chairman of Consumers United for Rail Equity (CURE), a rail customer advocacy group representing a broad array of vital industries – chemical manufacturers and processors; paper, pulp and forest products; farmers; cement and building material suppliers; and many more. Mr. Chairman, members of this coalition have experienced deteriorating service and sharply increased rates and appreciate the leadership shown by you and Congressman Baker in the effort to address the longstanding problems facing rail customers.

As member-owned, not-for-profit organizations, the obligation of electric cooperatives is to provide an affordable and reliable supply of electricity to our consumers. We take our obligation to serve very seriously. The personal and economic health of our members and our communities depends on it.

Mr. Chairman, we believe there is also an overriding national public interest in the operation of the rail system. The railroad industry is not just another private sector industry. Railroads provide vital services important to a range of national interest activities from the movement of war material, to distribution of some of the most important domestic energy sources, to providing vital links in the supply chain that bring domestically produced commodities and manufactured products to domestic and international markets. Unfortunately, we believe the railroads are not as serious about their obligation to serve the public interest as is my industry. They have consistently failed to fulfill their basic "common carrier" obligation.

Staggers Rail Act of 1980: Not What Harley Staggers Envisioned

On this month 27 years ago, Congress passed the Staggers Rail Act of 1980. A review of the debate from this landmark legislation reveals that Members of Congress envisioned a far different regulatory regime than is in place today. Mr. Chairman, our colleagues then spoke of a bill that would "assure a healthy vibrant system of railroads across the United States, and yet it would provide timely review to the Interstate Commerce Commission (ICC) by captive shippers who feel they are facing exorbitantly high rates charged by the railroads." Upon signing the Staggers Act, President Carter announced that the proposal would "benefit shippers throughout the country by encouraging railroads to improve their equipment and better tailor their service to shipper needs."

Unfortunately for the consumers in this country, these predictions have only partly become true. This nation's few remaining major railroads are exceedingly vibrant and prosperous, thanks to their unrestrained ability to increase prices at will and transfer almost every imaginable cost to the shipper. Clearly the railroads are not tailoring their service to shipper needs. In fact, high costs and unreliable service have become the accepted norm for most railroad companies and shippers simply have nowhere to turn.

The railroad industry continues to be protected by a Surface Transportation Board (STB) that is either unable or unwilling to provide adequate oversight. Under the watch of the STB and its predecessor the ICC, the railroad industry has been allowed to consolidate from over 40 major railroads in 1980 to four major railroads today that carry over 90 percent of the nation's freight. At virtually every opportunity the STB shows bias toward the railroad industry and recent actions suggest that without major reform, shippers, and ultimately consumers, will continue to be at the mercy of a railroad industry that we believe threatens the very health of our economy.

Government Accountability Office: Concerns About Competition and Capacity

The Government Accountability Office (GAO) recently issued a report outlining a pervasive and increasing lack of competition in the rail industry. The GAO report, first issued in October 2006 and supplemented and updated on August 15, 2007, found rail prices are on the rise and an increasing number of rail customers are paying more than three times what it costs the railroads to move their freight.

The GAO concluded:

- "Concerns about competition and captivity (in the rail industry) remain as traffic is concentrated in fewer railroads."
- "[The Surface Transportation Board's] rate relief processes are largely inaccessible and rarely used."
- "We believe that an analysis of the state of competition and the possible abuse of market power, along with the range of options STB has to address competition issues, could more directly further the legislatively defined goal of ensuring effective competition among rail carriers."
- "Significant increases in freight traffic are forecast, and the industry's ability to meet them is largely uncertain."
- "Costs, such as fuel surcharges, have shifted to shippers, and STB has not clearly tracked the revenues the railroads have raised from some of these charges."

The GAO report showed that freight rail rates are continuing to rise, even as carriers shift more and more costs. Railcars owned by freight railroads no longer carry the majority of tonnage. The GAO study concluded that railcar ownership has shifted by 20 percent since 1987, with rail company cars carrying only 40 percent of the load in 2005, compared with 60 percent in 1987.

Fuel Surcharges: New Profit Centers for Railroads

Over the years, railroads took in billions of dollars in "miscellaneous revenue," a category that includes, among other things, fuel surcharges. These charges are in

addition to the cost savings realized by requiring that railcars be provided by shippers rather than the railroads. For the past several years the U.S. Class I railroads have been over-collecting for fuel increases through fuel surcharges imposed on most of their customers. While the Class I railroads have dealt with increases in their fuel costs during this period, they have used fuel surcharges aggressively, transforming cost recovery mechanisms into profit centers. The railroads have collected far more in fuel surcharge revenue than the increase in fuel costs.

Wall Street analysts have publicly and repeatedly lauded the railroads' use of the fuel surcharge fees. After several years of hearing complaints from rail customers, the STB finally agreed in January 2007 that the railroads were in fact over-collecting for their fuel costs and that these practices were unreasonable. Unfortunately, the STB board members did not order the railroads to refund or credit to rail customers any of these ill gotten gains. The STB did not even suspend this "unreasonable rail practice" on the day of their decision. Unbelievably, they permitted the fuel surcharge over-collections to continue for another 90 days.

Railroad Profitability: A Golden Age of Railroading

The major railroads have entered a golden age of railroad profitability: record profits, record share prices and enough revenue to buy back billions of dollars worth of their stock in the last few years. This mature, basic American industry has even become the darling of hedge funds and other aggressive investors.

Simply put, the railroads have turned the corner from the difficult days that led to the Staggers Act and are now clearly able to attract and retain the capital they need to run their railroads and run them profitably.

The tremendous profits the railroads are earning are the direct result of their monopolistic practices, with the bulk coming from captive shippers who are left with no recourse but to pay the freight. These costs must be absorbed by someone and it is your constituents that are paying the price for the STB's failure. The current regulatory framework is unacceptable.

STB Process is Broken

The railroads suggest they are subject to strict regulation and shippers have a right to file complaints with the STB regarding rates. It is important to understand the very limited extent to which railroad rates are subject to review by the STB.

Only a small set of railroad rates are subject to any relief from the STB and these rates are not "regulated" in the classic sense of that term. Any rail movement for which there is a rail contract is exempt from the STB's jurisdiction altogether. In addition, the STB has exempted from its jurisdiction much other traffic (including inter-modal traffic) from its rate regulation. For the small remaining category of traffic that is subject to regulation, the railroads have the initial flexibility to impose on the customer any rate

they want without filing these rates with the STB for any form of "prior approval." The rail customer may then challenge the rate, but only if the rail customer can prove to the STB that the customer has no economically viable option but to use the railroad in question (an absence of effective competition) and the rate is at least 80 percent higher than the direct cost to the railroad of moving the customer's freight (the rate exceeds the jurisdictional threshold of 180 percent of variable costs). The rail customer then has the right to rate relief from the STB, but only if the STB finds that the rate exceeds a reasonable maximum. This reasonable maximum is called "stand alone cost" – what it would cost the customer at current cost to build and operate its own railroad to move its own freight. The rail customer in a "stand alone cost" case must pay a filing fee to the STB of $178,400 to begin this process.

In recent years, it has been impossible for shippers to obtain meaningful relief at the STB. While the jurisdictional threshold (or minimum a rail customer must pay) is set at 80 percent above the railroad's direct cost, shippers have been unable to get any rate relief when their rates amount to 3 to 5 times – or more – the direct cost of moving the freight in question. We believe very strongly that extracting margins of 300 to 500 percent – or even more – from rail customers, who have no option but to use a single railroad for transportation, is not what was intended by Congress. This is not just and is not in the best interests of the nation. In addition, the cases take at least two years to get the first decision on the merits and are very expensive, costing $3 million to $5 million in consulting and legal fees.

I will let Ron Harper of Basin Electric explain the details, but the STB's recent decision against Basin Electric and Western Fuels is another example of why the STB process is fundamentally broken. After Basin invested three years and more than $6 million, the STB essentially sanctioned a $1 billion transfer from Basin's member-owners to Burlington Northern over the next 20 years. Over this time period, BNSF's revenue over variable costs will increase to more than 845 percent.

Coal Delivery Problems Adversely Impact Consumers

Mr. Chairman, for the last three years the two railroads delivering Powder River Basin (PRB) coal to as far east as Georgia were falling 15 percent short on their deliveries. This forced utilities to take alternative actions, such as importing coal from Indonesia and Colombia, to replace this non-delivered coal and turning to natural gas to generate electricity, all of which cost their electric customers significantly.

NRECA has estimated that in 2006, there was a need for at least 370 million tons of PRB coal, but the railroads were able to deliver only 350 million tons of coal, reflecting a shortfall of some 5.4 percent. Replacing the 20 million tons of coal generation with natural gas translated into 340 billion cubic feet of natural gas. At an estimated average gas price in 2006 of more than $7 per thousand cubic feet, the additional cost of replacing the coal delivery deficit with gas translates to over $2 billion. The coal delivery problems had a similar impact in 2005 as well.

Moreover, these costs were exacerbated because the railroads and the coal suppliers sought to take advantage of the shortage in available coal transportation to raise rates and prices. In effect, the railroads profited from their service failure at the expense of the utilities and their customers.

The costly impacts of these rail delivery shortfalls are not a regional problem, but span the entire nation. Let me provide a specific example. From early 2005 through early 2007, Arkansas Electric Cooperative Corporation (AECC) received only 85 to 90 percent of the coal stipulated in its contracts with the two railroads that move Powder River Basin coal. The coal shortfall forced AECC to curtail coal burns. AECC's increased costs exceeded $100 million, causing it to increase bills to its customers by as much as 20 percent during the winter of 2006.

While the railroads have issued self-congratulatory news releases about coal stockpiles in 2007, this situation has not gone unnoticed by regulators. One of those regulatory bodies is the Federal Energy Regulatory Commission (FERC) which is charged by Congress to ensure reliability in the nation's electricity supply. Of course, the reliable generation of electricity depends on the reliable delivery of coal to electricity generators. In oral comments made at the May 17, 2007, open FERC meeting, Chairman Joseph Kelliher stated that although coal inventories were slightly improving, it did not mean there was not a problem. It meant that a problem could be just over the horizon. The Chairman felt that we were looking at significant coal generation additions in some parts of the country. He expressed concerns about whether the railroad investment in their coal moving capacity was adequate enough to account for that increase in coal generating capacity.

Chairman Kelliher noted, "It could be that we're one major rail line failure away from having the same situation that we looked at last year, so I think it's something we really need to keep an eye on, and keep on watching, because I don't think the fact that inventories right now are adequate means that there's no problem with coal transportation, and that it's something we don't have to show concern for anymore."

H.R. 2125 is the Solution: Reform Not Re-Regulation

Mr. Chairman, you have been a tireless advocate on behalf of rail customers for many years. We believe H.R. 2125, the Railroad Competition and Service Improvement Act of 2007 is a constructive and balanced approach to the problems facing our industries.

I want to address two allegations that are being made by opponents of this important legislation. First, many opponents charge that the legislation "re-regulates" the nation's railroads. One railroad CEO has even written a widely-distributed letter stating your legislation empowers federal bureaucrats to direct that one railroad can operate on the tracks of another, including the terms and conditions of this use of a competitor's tracks. This specific allegation is simply wrong. Nothing in your bill allows one railroad to operate on the tracks of another.

The mindless, provocative, general allegation of "re-regulation" is also flat wrong. No railroad rate that is not subject to regulation by the STB today will become subject to regulation under your bill. No provision of this bill empowers the STB to take any action that could be termed as "re-regulatory" under the most generous interpretation of that term.

H.R. 2125 does improve the process for determining if a railroad rate to a rail customer without access to competition is reasonable. But this legislation does not broaden the universe of rates eligible for this review process. The bill also does not reduce the minimum level of rate that qualifies for review by the STB. That minimum is a rate that is 80 percent more than the direct cost to the railroad of moving the freight in question.

The bill also overturns two improper interpretations of the Staggers Rail Act that allow the railroads to prevent their customers from reaching a competing railroad. One interpretation allows a railroad to refuse to provide a rate to a customer for moving across its system to a competing railroad system. A second interpretation allows major railroads to lease track to short line railroads and include provisions in the lease agreement that prevent the short line from doing business with any other major railroads. Some opponents of H.R. 2125 view these provisions as being "re-regulatory." In fact, these provisions are "pro-competitive" and will extend competitive deregulated rail service to more rail customers.

Second, opponents of H.R. 2125 like to use a graph that shows railroad rates declining significantly since 1980. This is a classic attempt to confuse this issue by introducing irrelevant information. The graph they use represents ALL railroad rates, not just the rates paid by rail customers without access to competition. Until the last few years, the majority of rail customers have had access to competition and their rates have declined significantly. The rates of the minority of customers without access to competition were not declining, but were "averaged out" by the declines in the competitive rates. If the railroads were to show a graph of captive rates over the last two decades, that graph would go in exactly the opposite direction as the graph showing declining rates.

Mr. Chairman, H.R. 2125 will provide the tools necessary to have the rail system the nation needs for the 21st Century. Your bill will bring forth the goals envisioned by Harley Staggers back in 1980. Rail customers will finally have an equitable forum to voice their concerns and a regulatory agency that is more than simply a rubber stamp for the nation's Class I railroads. Our nation's consumers deserve nothing less.

Conclusion

Mr. Chairman, thank you for conducting this hearing today. We look forward to working with you and Congressman Baker and with all of the other stakeholders involved to resolve these critical rail transportation issues in an objective and constructive manner.