Before The
Federal Energy Regulatory Commission

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| Discussions with Utility and Railroad Representatives On Market and Reliability Matters | Docket No. AD06-8-000 |

Statement of

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On

# Reliability of Coal Fired Power Plants Due to Coal Shortages

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My name is Glenn English. I am Chief Executive Officer of the National Rural Electric Cooperative Association. I also serve as Chairman of Consumers United for Rail Equity (C.U.R.E.), a captive rail customer advocacy group representing a broad array of vital industries such as chemical manufacturers and processors; paper, pulp and forest products; agricultural commodities producers and processors and cement and building materials suppliers.

I appreciate the invitation to appear before you today to discuss an issue that has rapidly risen to the top of the policy agenda for members of NRECA, a not-for-profit national service organization representing nearly 1,000 not-for-profit, member-owned rural electric cooperatives that provide retail electric service to more than 39 million consumer-owners in 47 states. NRECA, together with the Edison Electric Institute and the American Public Power Association, asked the Commission to examine the energy-market related impacts of rail delivery issues. We commend the Commission for now beginning the process.

Executive Summary

- Coal delivery by rail has been increasingly unreliable and expensive. Coal delivery problems by rail can impact the reliability of electric generation, the economics of electricity markets, and the economics of natural gas markets

- Coal stockpiles at individual utilities have been dangerously low over the past two years, with a number of utilities suffering coal stockpiles of less than ten days.

- Coal stockpiles have improved somewhat since last winter but they have improved because it was a mild winter, units were curtailed, and plants were taken offline for normal spring maintenance. Coal stockpiles are now on NERC's Watch List.

- Faced with reduced, unreliable coal supply, generators turned to expensive natural gas-based generation, exerting upward price pressures on natural gas markets.

- The failure of the railroads to reliably deliver coal has directly or indirectly produced winners and losers in electricity markets.

- Some domestic utilities are now purchasing coal supplies from foreign countries rather than from domestic sources, exacerbating our nation's balance of trade deficit.

- DOE has found that railroad industry consolidation, downsizing and increasing demand has resulted in lack of spare capacity.

- There is little competition for coal delivery by rail, and narrow railroad self interest results in continued congestion, producing upward pressure on rail transportation rates.

- The number of coal-fired generating plants is projected to increase substantially, calling into question the future reliability and cost of rail delivery, and railroad plans for expansion to meet this increased demand (see Attachment 1).

- FERC has jurisdiction to examine the problems of coal delivery problems as part of its new reliability jurisdiction and as part of its jurisdiction relating to continuity of service.

- As part of its market assessment and outlook studies, FERC should monitor coal stocks and the reasons for any shortfalls, just as it monitors the market situation for other fuels; FERC should encourage NERC to maintain a focus on coal delivery problems; FERC should commit to a future technical conference to examine whether current conditions have improved or worsened; FERC, through coordination with the Surface Transportation Board, should ensure that rail capacity increases sufficiently to support needed generation construction, and should report to Congress as appropriate.

Discussion

The Commission is now aware of our concern that a lack of timely deliveries of sufficient coal to generating plants across the country can result in disruptions in electric service. Such disruptions – depending on circumstances – may be localized or extend to large regions, and could be short or longer duration.

Coal delivery problems also result in enormous negative economic effects that bear directly on the issues addressed in the regular assessment and outlook reports that have been presented by Commission staff at the Commission's public meetings. Where coal delivery problems have negative reliability effects, the Commission's new statutory reliability authority is also directly implicated. Coal delivery problems relating to continuity of service implicate Commission authority under the Federal Power Act Section 202(g).

Approximately 50 percent of the nation's electricity is currently generated from coal. Among electric cooperatives, almost 80 percent is generated from coal. Since few cooperative generating facilities are located at coal mine sites, much of the coal is delivered by rail. Cooperatives typically purchase coal at the mine site and contract with railroad companies for transportation by rail. Pursuant to those arrangements, cooperatives are required to provide and maintain the "trainsets" – the unit trains that today normally number from 120 to 135 cars. They also provide unloading facilities and make other related capital investments. The railroads provide the locomotives, the tracks, the crews and the diesel fuel for the locomotives.

Our generators are increasingly faced with declining service and higher rates from the railroads. Consolidation of the rail industry has resulted in many of our generators being held "captive" by a single railroad. They are subject to railroad monopoly power

over price and service with no access to competition. The railroads have little incentive to improve service or reduce rates notwithstanding that rail traffic is growing and there is a need for investment in rail infrastructure. The nation now faces a situation where the railroads are either unable or unwilling to deliver reliable supplies of coal to our generators in a timely fashion. Our members are consequently paying much more and receiving far less when it comes to rail transportation of coal.

As a result, a number of the electric cooperative generators have experienced extremely low coal stockpiles. Most utilities seek to maintain no less than thirty days of coal inventory at each of their plant sites to provide a cushion to cover disruptions in the fuel supply chain. Unfortunately, the railroads' poor coal deliveries over the past several years have substantially disrupted utility efforts to maintain those stockpiles. Some generating facilities have recently come dangerously close to the point where continued operation cannot be sustained. If these units are forced to reduce their production of electricity, they will either have to use more natural gas generators – at fuel costs as much as five times as high as the cost of coal – or buy excess electricity on the grid, typically also produced from gas, if it is available. If the natural gas or excess electricity is not available, certain areas of the nation could be short of generating capacity and brown outs or rolling black outs just like those experienced in Texas last April.

These problems have not suddenly materialized. They are a continuation of problems that have plagued the utility industry since at least 2004. For example, in a letter dated June 24, 2005, to the Surface Transportation Board from the Western Coal Traffic League, an association of western utilities, including co-ops, noted that some members experienced 20 percent volume reductions in 2004 and that several members had stockpiles in the first part of 2005 that were below ten days. While the railroads may seek to blame the customers for the low stockpiles, the fact is that many shippers have been trying to replenish their stockpiles for several years—particularly from the Powder River Basin-- albeit to little avail. While the railroads may point to unprecedented coal demand, the fact is that coal demand reflects essentially a straight line continuation of established growth trends and is consistent with projections such as those of the Energy Information Administration of the Department of Energy.

Our nation is blessed with enormous reserves of coal that can provide for electricity for many future decades. In a 2001 speech, Vice-President Dick Cheney pointed out that the overall demand for electric power is expected to rise by 43 percent over the next 20 years, and that just meeting the demand would require between 1,300 and 1,900 new power plants. That averages to more than one new power plant per week, every week, for the next 20 years. Many of these plants are expected to run on coal.

Vice-President Cheney may not have recognized at the time of his speech that the railroads were already in the process of making America's most abundant and affordable energy supply scarce and expensive. When electric co-ops are looking to South America, Indonesia and other foreign coal sources because the railroads here cannot make timely domestic deliveries, we know the *status quo* cannot stand.

Commission Chairman Kelliher, when commenting on the President's State of the Union Address, stated that our nation must build the energy infrastructure necessary to meet the challenges of the 21st Century. NRECA's members are meeting the challenge. Cooperatives expect to spend $35 billion over the next 10 years, 77 percent of which will be for new coal-fired power plants. An inquiry into whether there will be sufficient, effective, rail capacity to deliver the coal for these new units, as well as keeping up with current plants and other freight haulage is clearly legitimate.

Let me focus on the coal delivery problem confronting just one very large coal-fired electric generator in Wyoming – the Laramie River Station. In the spring of 2005, there were two derailments on tracks coming from the Powder River Basin (PRB), the source of the nation's largest supply of low sulfur coal. This reduced rail deliveries of coal to 80 or 85 percent, and deliveries have not yet fully recovered. In fact, a spokesman for the BSNF which serves this station was recently quoted in CQ Weekly as saying that it is just not feasible to rebuild the LRS stockpile with demand for coal so high. It is unclear whether those reductions have been imposed across-the-board, or whether the reductions and related matters, including "parking" of trainsets, have been imposed selectively or accidentally, but the result is the same. It enables the railroads to pick "winners and losers" among generating utilities, and to potentially punish and retaliate against those who seek to invoke whatever protections may be ostensibly available.

The three unit (1650 MW) Laramie River Station in Wheatland, Wyoming, located only 170 miles from the coal source, was down to a 3 to 4 day supply of coal in January. This plant is operated by Basin Electric Power Cooperative for 6 not-for-profit utilities. Loss of this major block of generation could have severe reliability problems to its regional grid. Basin provides electricity to its members in 9 states serving over 1.8 million consumers. Because of reliability concerns, Basin notified DOE and the North American Electric Reliability Council of the stockpile situation when coal reserves dropped below 50 percent of normal levels and developed a generation curtailment plan to conserve coal. Fortunately, the winter was relatively mild, coal deliveries improved during the last few months, and Unit 1 entered a 7 week maintenance outage, which reduced consumption of coal. Since the outage began on April 15, Basin's stockpile has increased to almost 700,000 tons. However, if the plant had been operating at full load during this period, the stockpile would have gained only 100,000 tons to a total of 276,000 tons; a 10 day supply of coal (see Attachment 2). Now that the plant is once more in full operation, Basin is concerned about coal deliveries for the summer months. Although Basin and other NRECA members have partially rebuilt their stockpiles, another rail outage could severely impact their production and decrease system reliability.

Other co-ops have experienced similar problems and have cut production at those coal plants that are normally the least expensive to operate. Electricity generators have resorted to burning more expensive natural gas, purchasing higher cost electricity from the grid, or purchasing more expensive foreign coal and higher sulfur local coal. Arkansas Electric Cooperative estimated that its coal conservation program, using alternate-fuel power generation, cost its customers over $100-million because of the shortage of coal deliveries over the past 12 months to its power plants.

The Office of Electricity Delivery and Energy Reliability (OE), U.S. Department of Energy, analyzed coal delivery from the Powder River Basin in 2005 and updated it this year. It stated that "[c]onsolidation has left the rail industry with just a half-dozen major operators, who have been cutting rail routes and costs since the industry was deregulated in 1980. The result of downsizing and increasing demand for freight movements has left the rail industry with little spare capacity in terms of track, cars, or locomotives. After a disruption has ended, the lack of spare capacity makes it very difficult to compensate for the lost deliveries by running more cars or trains on the already congested tracks."

In the 2006 OE update, Burlington Northern is quoted as saying that "[t]otal PRB rail delivered coal in 2005 was about 423 million tons. However, according to U.S. Senators Burns, Rockefeller, Craig, and Dorgan, this was 20 million tons short of commitments between [Powder River Basin] coal producers and the utilities they serve in some 35 states. Although coal production and rail delivery are expect to reach record a level this year, rail delivery is still expected to fall short by 20 million tons." Replacing a 20 million ton expected shortfall of PRB coal deliveries in 2006 will require approximately 340-billion cubic feet of natural gas costing about $2.6-billion more than the coal. The additional use of natural gas for generation instead of coal also affects the supply and price of natural gas across the country, and – again illustrating the adverse impacts on other industrial sectors – increases the costs to those using natural gas as a feed-stock in manufacturing their products. Restriction in the supply of PRB coal has also contributed to a tripling of the coal spot market price in the second half of 2005, increasing those prices from roughly $6.00 per ton to more than $20 per ton.

The North American Electric Reliability Council 2006 Summer Assessment explicitly noted that PRB deliveries are increasing, but not enough to restore coal inventories to pre-curtailment levels. While coal delivery limitations do not appear to present a reliability problem for this summer, they have placed the PRB issue on its "Watch List" and will continue to closely monitor developments, both for the coming summer and the longer term. NERC does not lightly add items to its Watch List.

**Next Steps:**

As part of its market assessment and outlook studies, FERC should monitor coal stocks and the reasons for any shortfalls; FERC should encourage NERC to maintain a focus on coal delivery problems; FERC should commit to a future technical conference to examine whether current conditions have improved or worsened; FERC, through coordination with the Surface Transportation Board, should ensure that generation construction is synchronized with transparent, needed rail construction, and should report to Congress as appropriate.

I can assure you that the 39 million consumer-owners of the NRECA electric cooperative family look forward to working with you, and with all of the other stakeholders involved, in resolving these critical rail transportation issues in an objective and constructive manner.

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Any questions or communications concerning the statement should be submitted to the following:

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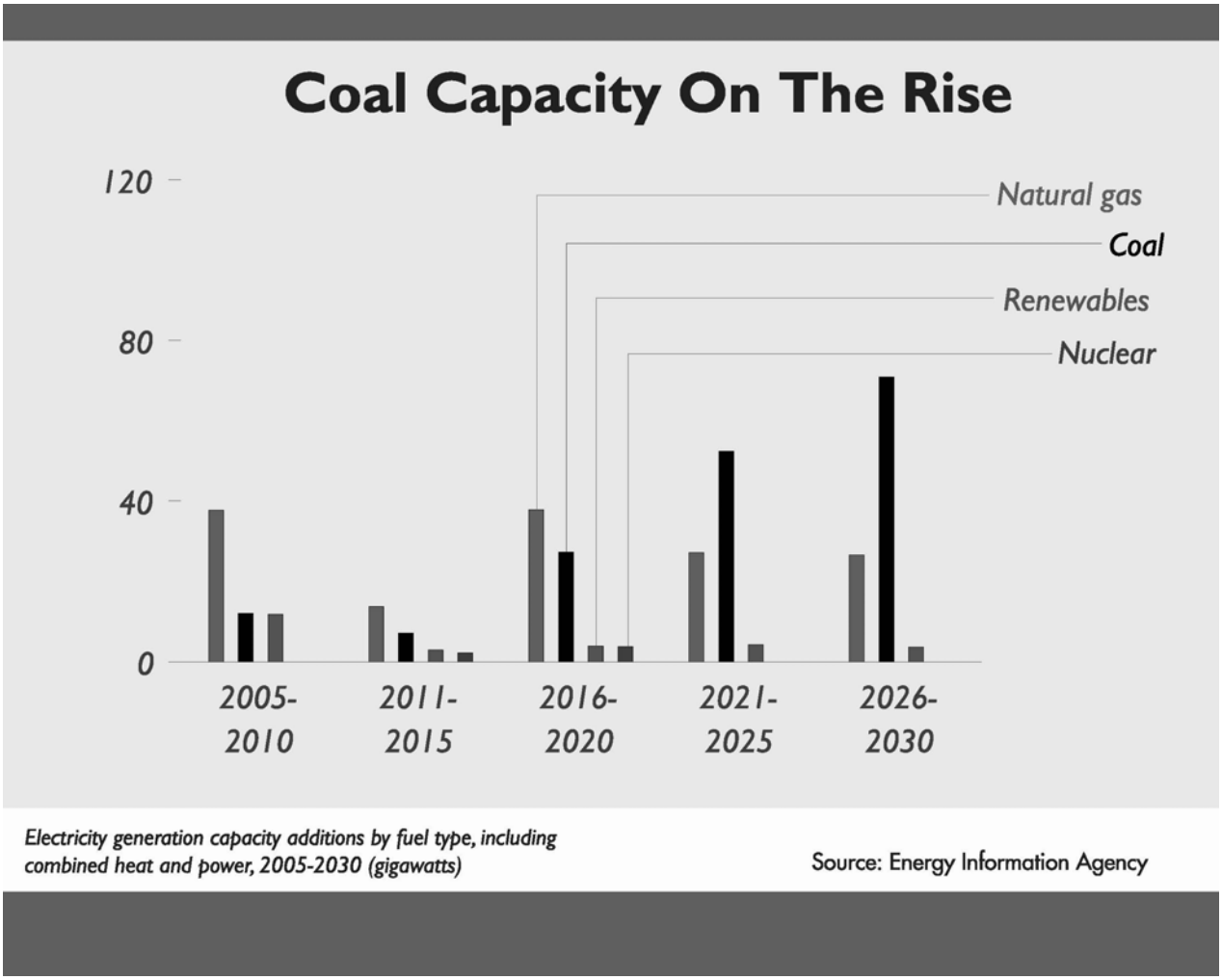
Attachment 1



Attachment 2