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Testimony of Terry Huval
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Before the
House Transportation and Infrastructure Committee

Hearing on Rail Competition and Service

Mr. Chairman and Members of the Committee, My name is Terry Huval, and I serve as the Director of the Lafayette Utilities System ("LUS"). I am also appearing here today on behalf of the American Public Power Association (APPA). I currently serve as the Chairman of APPA's Board of Directors. I appreciate the opportunity to participate in this hearing to discuss the current state of competition and service in the railroad industry.

This is the second time I've had the privilege to testify before this Committee on rail customer matters. In the spring of 2004, I testified before the Railroad Subcommittee on the significant problems LUS was facing in obtaining reasonable rail rates. I wish I could tell you today that the railroad competitive and service situation is better today than it was three years ago when I appeared before the Committee. Unfortunately, things are not better. In fact, things have grown substantially worse, and I believe there is more need than ever for Congress to step in and address these important issues.

I. LUS'S COAL-FIRED GENERATING ASSETS AND IT'S RELIANCE ON THE RAILROADS

LUS is publicly owned and operated, and is a part of the City of Lafayette, Louisiana, a relative small community located approximately 135 miles northwest of New Orleans. LUS exists to serve the electric power and other utility service needs of the approximately 120,000 citizens and business owners in Lafayette. LUS is committed to providing electricity to the citizens and businesses of Lafayette at the lowest possible cost and the highest reliability of service.

While LUS owns a mix of coal- and gas-fired electric generation on which it relies to meet customer demand, the majority of our power is derived from the 523 Megawatt coal-fired Rodemacher Power Station Unit No. 2 located in Boyce, Louisiana. LUS is a 50 percent owner of the Rodemacher plant, the remainder of the facility is owned by CLECO Corporation, an investor-owned utility in Louisiana, and 5 municipalities in Louisiana through their membership in a joint action agency. This Rodemacher coal unit has been in operation since 1982. LUS has no other viable, economic options to replace its baseload Rodemacher power from any on- or off-system electric generating sources.

The Rodemacher plant's co-owners obtain the coal used at Rodemacher from mines in the Wyoming Powder River Basin (PRB) and collectively purchase approximately 2 million tons of coal annually for use at Rodemacher. The only practical way to transport this coal from Wyoming to Rodemacher (a distance of over 1,500 miles) is by rail. To facilitate our rail deliveries, the Rodemacher co-owners have obtained and maintain, at our own expense, four (4) train sets of coal cars (over 482 cars).[1]

II. LUS'S RAIL COMPETITION CONCERNS

LUS is a classic captive shipper. The Rodemacher station is served by only one railroad, the Union Pacific Railroad Company (UP). LUS theoretically has competition for much of its Rodemacher rail service. Two railroads originate coal in the PRB, the UP and the BNSF Railway Company (BNSF). In this respect, BNSF and Kansas City Southern Railway Company have connecting rail lines in place covering approximately 99 percent of the 1,500 miles between the PRB coal mine origins and Rodemacher. However, we are captive to UP at destination which serves the last 20 miles into the plant in Boyce.

UP uses its monopoly "bottleneck" control over rail line facilities at plant destination to extend its 20 miles of monopoly power to the entire 1,500 miles of the route from the PRB to Rodemacher. In other words, UP's exclusive

[1] Also, as explained below, in order to facilitate improved Rodemacher rail service, and mitigate against recent railroad service lapses, LUS is spending millions of additional dollars on new railcar equipment.

control of one percent of the involved essential rail lines enables UP to control 100 percent of the Rodemacher movements. How does UP do this? Rodemacher is only able to get one rate for service that locks it to the UP: a rate for the entire PRB-to-Rodemacher trip. UP's policy is to refuse to provide separate rates for the 1,480 mile competitive segment of our movement and the 20 miles of the captive movement. This renders Rodemacher captive to UP for the entire origin-to-destination trip.

A. <u>The Price of Captivity – Then and Now</u>

The cost of coal transportation is one of the single largest LUS electric generation cost items. In my testimony to the Railroad Subcommittee in 2004, I explained that, because LUS is subject to a railroad monopoly, LUS paid substantially higher coal transportation prices than other western coal transportation customers that enjoyed effective origin-to-destination rail competition. At the time, publicly available information suggested that our 2004 transportation prices were at least 50% higher, on a mileage adjusted basis, than rates where there is rail-to-rail competition for long-haul western coal train deliveries.

I emphasized in my prior 2004 testimony that, for Lafayette, Louisiana, this lack of railroad competition translated into <u>approximately $5 to $6 million</u> dollars per year (approximately 20% of the total cost of delivered coal in 2004) in "captivity payments" – the difference between what we pay our existing rail carrier compared to what we would pay if we enjoyed railroad competition.

These higher payments were and are included in LUS' customers' monthly electric bills and cause higher utility bills both for individuals and for the businesses in Lafayette.

Unfortunately, since the time of my last testimony, the economic impact of LUS's railroad captivity problem has <u>significantly worsened</u>. LUS's last contract with UP expired at the end of calendar year 2005. We approached UP and attempted to negotiate reasonable rates and terms for our Rodemacher service. Unfortunately, UP refused to meaningfully negotiate new terms with us. Rather, UP presented LUS with its new "Circular 111" rates and terms for Rodemacher service. These rates and terms were not negotiable. We were left with little choice but to accede to UP's demands because of their monopoly control over LUS.

LUS pays significantly higher rates today under UP's new public pricing scheme than in 2005. LUS's 2007 rates are approximately <u>26 percent higher than 2005 levels</u>. Further, UP refused to provide us with any effective service guarantees, which we always had under our prior contractual arrangements with UP. To add insult to injury, our rail service has generally deteriorated since 2004, as UP has suffered well-known PRB coal delivery problems in 2005-2006. Thus, LUS is saddled with paying much higher rail rates with no service guarantees, and virtually no ability to seek compensation for UP's service failures. In response to these UP delivery failures, Lafayette has taken extraordinary measures to help ensure an adequate coal supply. As examples, LUS had to buy barge-delivered coal from Venezuela and truck lignite from Northwest Louisiana to help shore up its fuel inventory needs.

This lack of service commitment, combined with the recurring service problems UP has experienced in recent years, has left LUS with little other choice but to spend additional public monies in an attempt to address the situation. LUS has always obtained and provided the private railcars that are utilized by UP for LUS's Rodemacher service. However, in an effort to mitigate against UP's recent service slowdowns, and to help ensure that we are in the best position possible to meet the Rodemacher plant's annual coal requirements, we are acquiring new aluminum railcars to replace our older steel railcars. By using the lighter weight aluminum cars, more coal per trainload can be shipped while staying within gross weight limits. LUS expects to spend approximately $19 million on these new railcars, which we hope will assist UP to deliver more coal to Rodemacher in a timely matter, and meet Rodemacher's annual coal volume requirements. But there are no guarantees and we are receiving little in return from UP for making these expensive changes that produce considerable operating expense savings for UP. These are significant costs for a small utility that LUS would not need to incur if it was otherwise receiving reliable service and/or was able to obtain reasonable guaranteed service standards from UP.

In sum, in 2004, LUS was paying uncompetitive high rates to its monopoly railroad service provider. Today, those rates have increased significantly, and our service situation has deteriorated. That has led LUS to spend even more money on railroad equipment in an attempt to improve railroad service. The Citizens of Lafayette, Louisiana are essentially being asked to pay more for less service, and there does not appear to be any end in sight to the problem.

LUS is not the only railroad customer experiencing significant issues with regard to the railroads. Attached to this testimony is an Issue Brief and an Action Alert recently prepared by APPA describing the problems that many, if not all public utilities are experiencing today with regard to rail rates and service. This problem is of national significance, and it affects millions of electric utility ratepayers who must pay the monopoly rate demands being made by the railroads, and who have experienced considerable economic harm in recent years because of railroad service failures. I respectfully request that these APPA materials be included in the record along with my written testimony.

B. <u>The Need to Address the Railroad Problems</u>

LUS is extremely concerned that UP will continue to attempt to exploit LUS because of our captivity to the railroad. Something needs to be done. Our customers are paying unnecessarily high electricity prices because our coal-fired generating facility is served by a single railroad.

1. <u>The Need for Effective Regulation</u>

Actions by monopolists to restrict competition, raise prices, and remove meaningful service standards raise serious anticompetitive concerns, and inhibit our ability to achieve reasonable rate and service terms for Rodemacher.

Basic economic principles instruct that markets works best and create value where competitors openly and aggressively compete for business -- and not where carriers openly dictate rate and service terms. Where there is a lack of effective competition in the marketplace, there is a need for strong regulatory backstop protections to protect the public.

Unfortunately, the STB has effectively ignored the need for substantive administrative relief. STB rate case litigation costs are extraordinarily high, approximately $4-$5 million for the complaining customer, and rate cases take two to three years to litigate. Additionally, the recent STB rate case decisions raise serious questions about whether the regulators have skewed the governing "stand-alone cost" (SAC) standards in a manner that has eviscerated the effectiveness of regulatory backstop protections afforded under the law. For those that bring cases, the trend of STB decisions in recent years has been one-sided in the direction of sanctioning abusive rail rate practices, and there has been very little evidence of balanced decisionmaking. At best, the STB has set the bar for meaningful captive shipper relief inordinately high.

Additionally, even where partial or potential competition exists, such as bottleneck situations, regulatory policy allows railroads to neutralize it, rather than shippers to competitively utilize it. The railroads are able to get away with these anti-competitive rate practices, in part, under the STB's so-called "Bottleneck" decision. That decision sanctions the rail carriers' practice of refusing to provide separate rates over bottleneck line segments. This enables railroads to exploit their monopoly power over bottleneck rail line facilities as described above. The result is that the Rodemacher station and in turn the citizens and businesses of Lafayette are captive to UP and is subject to UP's monopoly pricing power. Many other shippers are similarly situated.

In the past, LUS and its Rodemacher co-owners have explored constructing facilities that would allow direct alternative rail providers access to Rodemacher. In our case, any such access would most likely entail construction of a prohibitively expensive rail bridge or conveyor system across the Red River and Interstate 49. It seems absurd that current federal transportation policy would require small municipal entities like LUS to even study such projects when other alternatives make much more sense, such as, for example, requiring our existing carrier to transport our coal the 20 miles from Alexandria, Louisiana to Rodemacher at a fair price. With such a legal requirement, there would be no need for us to consider construction of costly, duplicative second carrier access facilities at a cost that would be passed on to our electric customers.

Moreover, in today's market environment, it appears that "build-out" options have been effectively neutralized. That is because UP and BNSF are no longer effectively competing for western coal service. UP and BNSF have each announced "public pricing" programs to apply on PRB coal movements upon the expiration of existing contracts, to apply on both "competitive" and captive traffic. Those programs, implemented under UP Circular 111 and BNSF Tariff 90068, are characterized by higher rates and an absence of meaningful service standards.

Through UP and BNSF's new public pricing programs, the carriers appear to have essentially adopted a "take it or leave it" approach to negotiations. Both carriers also acknowledge that the goal of these new programs is to increase carrier revenues at the expense of railroad consumers. Thus, even if LUS were to take the extraordinary step of spending millions of dollars on an expensive new build-out line to reach competitive connections, there is little reason for us to believe that our overall transportation costs would be reduced or that our investment in new rail facilities could be recovered.

III. WHAT CAN CONGRESS DO TO ADDRESS THE PROBLEM?

As explained, all appearances are that the STB today is not receptive to complaints seeking rate reductions, and that the prevailing regulatory environment is characterized by an absence of effective regulation. Under the standard "utility model" that LUS and many other electric utilities are regulated under today, any rate increase requests must be fully cost-justified and approved by regulators prior to implementation. This model is turned on its head when it comes to the regulation of railroads. Railroads are able to unilaterally impose rate increases on its monopoly customers without providing any justification for the new rates; customers must file a complaint and spend millions of dollars and several years to challenge the new rates in an attempt to block the new rates; customers must pay the railroads rate demands during the pendency of cases; and customers have all of the burdens of proof to show that the challenged rates are unreasonable.

LUS respectfully submits that this model does not make any sense and there is a compelling need for additional regulatory scrutiny of railroads. The appropriate government role must be to take all reasonable efforts to protect consumers from economic abuses by monopoly rail providers, not protect the carriers' monopoly revenue streams. Maintaining more appropriate protections for the establishment of reasonable common carrier rates to the railroads= market-dominant customers is essential. Additionally, the fact that there is the theoretical possibility of rail competition covering approximately 99 percent of the lines that could be used to serve Rodemacher from mine origin to destination is of absolutely no benefit to LUS under existing STB's bottleneck policy. LUS respectfully submits that the STB's Bottleneck decision is anti-competitive, anti-consumer, and senseless national rail policy.

H.R. 2125, the Railroad Competition and Service Improvement Act, provides a step in the right direction toward addressing the above problems. In this respect, I would like to thank Chairman Oberstar, and Congressman Baker from my home state of Louisiana, in particular for their leadership on this important initiative. Among other things, this bill includes modest corrections to address misguided STB decisions and policy determinations that are needed to restore a modicum of restraint on market dominant railroads. The bill would create a new maximum rate standard and would require carriers to quote reasonable rates to or from the point of access to existing rail competition.[2] Mr. Chairman, this seems fair to both the railroads and to their customers.

In this respect, with the advent of railroad "public pricing" programs and recurring service lapses occurring following the recent consolidation of the railroad industry that are causing competitive harm, I believe that there is a need for Congress to consider engaging in additional oversight of the operations and marketing practices of the railroads, including being alert to possible anticompetitive effects. Congress could carry out this oversight responsibility by requiring an appropriate independent entity other than the STB (whose policies have allowed the current competitive situation to be created and persist) oversee the railroads and regularly report to Congress on its oversight and on its recommendations for competitive and regulatory improvements.

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Mr. Chairman, thank you again for inviting me to testify. Our electric ratepayers are suffering from a lack of effective competition or regulation of the railroads, and LUS and APPA respectfully submits that Congress can and should address this matter as soon as possible.

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[2] As explained above, while the overturning of the STB's bottleneck decision, would, at best, leave LUS subject to duopoly competition, overturning this misguided policy is pro-consumer and a step in the right direction.