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On Behalf of

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Testimony

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United States Senate

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Chairman Domenici, Ranking Member Bingaman and members of the Senate Energy and Natural Resources Committee, I appreciate the opportunity to appear before this committee today to share Tri-State Generation and Transmission Association's views regarding the outlook for coal-based electric generation both in the near term and in the future and the role that rail transportation will play in that outlook. I have also attached to my testimony comments made by Glenn English with the National Rural Electric Cooperative Association, regarding this matter.

My name is Mac McLennan. I am the Vice President of External Affairs for Tri-State Generation and Transmission Association, a not-for-profit wholesale power supply cooperative that generates and transmits electricity to forty-four member distribution cooperatives and public power systems in Colorado, Nebraska, New Mexico and Wyoming. Tri-State serves over one million people throughout our 250,000 square-mile service territory and employs more than one thousand people who, each day, ensure that our member consumers will receive the electricity they need to run their businesses, irrigate their farms, provide water for cattle and live their daily lives.

This hearing concerns the outlook for growth of coal fired electric generation, and whether or not there will be sufficient supplies of coal available on a timely basis in the future. As the committee will hear, Tri-State and our members have a plan to meet the demand for coal fired electricity – both current and future – but we also want you to know that rail freight rate issues, delivery problems with coal, current monopolistic and anti-competitive practices of the major rail carriers, and the rate challenge process at the

Surface Transportation Board (STB) are having a significant negative impact on our member-consumers and electricity customers nation-wide and must be resolved.

Coal, Electricity Reliability and Obligation to Serve

As a member-owned, not-for-profit electric cooperative, it is Tri-State's mission and obligation to provide a reliable source of electricity to our member-consumers at the lowest possible price consistent with sound business practices. We have a "public utility" obligation to provide electricity to all in our service area. We take this obligation to serve very seriously. We are keenly aware that we provide an absolutely essential service to our customers. People living in the communities that we serve depend on our reliable supply of affordable electricity to run their businesses, to light, heat and power their homes, and to operate the hospitals and other emergency services needed to keep the people in rural America safe and healthy.

Like so many other electric utilities across the country, Tri-State is experiencing tremendous growth in baseload electricity demand. Baseload refers to the minimum amount of electricity we need to have available on a 24-7-365 basis to meet the needs of our consumers. We are growing in our baseload requirements by approximately 100 MW per year. To meet the growing demand for electricity in our service area, Tri-State is planning to build more than 1800 megawatts (MW) of new super-critical pulverized coal-based generation over the next fifteen years.

As we look to the near term fuel supply options, coal is the answer to meet our future baseload requirements. We depend on coal for our current baseload requirements as well.

As of year-end 2005, sixty seven percent of Tri-State's owned and contracted supply of electricity was produced from coal, 14 percent from hydroelectricity, 11 percent contracted from Basin Electric Power Cooperative, which primarily generates using coal, 6 percent purchased power from the grid and less than 1 percent from natural gas, oil and renewables. As you can gather from our resource base, Tri-State relies on coal-generated electricity for more than 70% of our current needs.

In our resource planning process for future requirements, Tri-State has considered all currently available and realistic options – including renewables – for new generation. We have found that there are only three fuel resources currently available to meet future baseload generation needs: (1) nuclear, which appears to be several years away and faces significant siting difficulties and a lengthy permitting process; (2) natural gas, which is a volatile and expensive fuel, and for which there have been supply problems; and (3) coal, a proven, low-cost, domestically abundant resource.

Tri-State might be considered fortunate because our operations are located near the nation's largest supply of coal, the Powder River Basin (PRB). However, despite our relative proximity to this enormous supply, we must be confident that we can obtain timely deliveries of this resource as we make plans to build new coal-based generation. If there are continued constraints on rail lines moving out of the Powder River Basin to other parts of the nation, there will be a significant negative impact on Tri-State's ability to meet its service obligations in the future. If the major rail carriers are permitted to continue their monopolistic, anti-competitive practices, the cost of providing electricity using America's vast reserves of coal may force generators to rely on other fuels and even to foreign suppliers.

In addition to the obligation to meet our members' electric needs in a cost effective fashion, Tri-State must ensure that we maintain the reliability of the electric utility system as well. As the members of this committee are well aware, the Energy Policy Act of 2005 requires the establishment of mandatory electric reliability standards. Our ability to meet the requirements of that section could be jeopardized if we cannot cost-effectively access the coal resources of the nation due to rail delivery issues. Thus, we believe that reliable delivery of coal by rail is integral to electric reliability.

The railroad industry, like electric utilities, must also be subject to an obligation to serve its customers and the national interest. This obligation may be called in railroad law a "common carrier" obligation, but at its base it is an obligation to serve. This obligation to serve means an obligation to provide reliable transportation service at reasonable rates to its customers and to the nation. Without requiring that the railroads fulfill an obligation to serve, our nation's economy is stymied and America will not be able to sustain necessary levels of economic growth and meet the challenges of global competition. Adequate, dependable, and reasonably priced rail service is –like electricity – critical to our national and economic security interests.

Today, there appears to be no government agency to which rail customers can turn for redress when severe railroad service problems are experienced. Last year, the CEO of Arkansas Electric Cooperative was confronted with severe rail coal delivery problems that cost their customers at least $100 million. In August, 2005, he sent a letter to the Surface Transportation Board (STB), the agency created by Congress to supervise the railroad industry, particularly in railroad monopoly situations. Interestingly, he never received even an acknowledgement of his letter from the Surface Transportation Board. Instead, his letter was answered in November, 2005 by the Burlington Northern Railroad, one of the two railroads about whom he was complaining. The STB has held no hearings or other inquiries into the rail coal delivery problems from the Powder River Basin, which became critical in 2005 and continues to be a critical problem in 2006.

The STB has shown little interest in rail service issues and has no history of directing railroads to provide service to shippers where service is inadequate. As a 24 percent owner in Laramie River Station (LRS), a coal-based generating station in Wyoming, Tri-State's member-consumers have been hit directly at LRS by both increased rates and reduced coal shipments. Indeed, the member-consumers of LRS are paying more and receiving less rail service.

LRS is served by a single railroad, Burlington Northern and Santa Fe Railway Company (BNSF). BNSF is supposed to deliver 8.3 million tons of coal annually from the Powder River Basin to LRS, a distance of approximately 175 miles.

In order to maintain efficiency, coal-based generating plants like Laramie River Station are run almost continuously. Maintaining full generation levels at the 1,650 megawatt level, the three-unit LRS plant requires 24,000 tons of coal per day, the equivalent of one and a half trains of coal daily. (A "train" consists of about 136 rail cars, each carrying about 120 tons of coal) In addition, a coal stockpile is maintained at the plant site, which is used as backup in case of an interruption in rail deliveries. To ensure reliability of service, we typically try to maintain more than a 30 day supply of coal in the stockpile.

Earlier this year, coal delivery problems resulted in a stockpile that would serve the plant for only 6 days. If the stockpile at LRS had been depleted any further, we would have been forced to curtail generation at a significant cost to our member-consumers. If LRS had been forced to curtail electricity generation, we would have had to either use natural gas generators – at fuel costs as much as 5 to 7 times higher than coal – or buy excess electricity on the grid, if available, at much higher costs than the electricity produced at LRS. In some parts of the nation, neither of these emergency backup options is available, and consumers could experience brownouts or rolling blackouts when coal supply falls short at generators. Fortunately, stockpiles at LRS are now building back up due to slightly improved delivery times from BNSF, the addition (at a cost of about $10 million paid by Tri-State), of a fourth train set, and – more importantly – because a scheduled seven week maintenance outage of one of the three LRS units reduced the overall daily coal demand by one-third.

Across the nation, the failure to deliver Powder River Basin coal is costing consumers hundreds of millions, if not billions, of dollars in increased electricity costs. In 2006, the need for PRB coal is calculated to be 370 million tons or more, but the railroads themselves are forecasting they can make deliveries of only 350 million tons. With coal inventories already depleted, utility generators dependent on PRB coal can anticipate a 20 million ton shortfall. Replacing 20 million tons of coal generation with natural gas generation will require 340 billion cubic feet (BCF) of natural gas. At an estimated average gas price in 2006 of $7 to $9 per cubic foot, the cost for replacing this loss of coal generated electricity in 2006 will be an estimated $2.0 billion to $2.8 billion.

As of February 2006, the 340 BCF of natural gas needed to replace coal generation represented approximately five percent of all the natural gas currently in storage in the nation and almost 1.5 percent of the nation's total gas usage. Electricity generation is a less than ideal use of natural gas, which would be better saved for other purposes. Using such a large percentage of stored natural gas for electricity generation would only serve to drive up costs for both electricity and natural gas heating. Additionally, coal delivery problems from the PRB have contributed to spot market coal price increases. All of these costs contribute to the rising cost of electricity, which is not only impacting residential customers directly but is also contributing to increased costs for goods and services.

We at Tri-State are concerned that the continued supervision of the railroad industry that was contemplated by Congress in 1980 is not occurring. Congress deregulated most railroad activities on the theory that competition would improve both the efficiency and prosperity of the nation's railroads and result in reliable and cost effective rail service for the nation.

Our experience is that, under the current supervision of the Surface Transportation Board, railroads are allowed to charge excessive rates where there is no viable transportation competition and we must be satisfied with whatever level of service the railroads provide. In addition, with demand for railroad services far exceeding the supply of railroad capacity, the railroads have what Wall Street analysts identify as “perfect pricing power”. Thus, we are concerned that, in the absence of governmental supervision, the railroad industry may have no incentive to jeopardize their pricing power by adding sufficient capacity, particularly for rail customers, like us, that have no access to transportation options. Unless the railroads provide sufficient and reliable transportation capacity for our coal movements, we will continue to face reliability problems for the foreseeable future.

Rail Rate Concerns

In addition to the rail delivery concerns being looked at by this committee, Congress should also be concerned about the cost of coal delivery to those facilities, like ours, that must depend on a single railroad for coal delivery. Coal delivery costs flow straight through to our customers many of whom are farmers who are already paying high rail rates on the movement of their crops to market. When we must rely on a single railroad to move coal to our plants, we are in no position to negotiate a mutually acceptable price. Rather, both price and service are provided to us by our railroad carrier. With the railroads exempt from the nation’s antitrust laws, the only option available to customers served by a single railroad is to petition the Surface Transportation Board for relief.

The process for rate challenges at the Surface Transportation Board (STB) is costly and burdensome. At the end of a twenty year contact with LRS, BNSF more than doubled the coal hauling rate for the plant. On October 19, 2004, Basin Electric, LRS’s operator, and Western Fuels, which acts as agent for Basin’s coal supply and transportation needs, filed a complaint with the STB to review BNSF’s rate increases. Rate complaints at the STB are costly, lengthy, complex and rarely result in a victory for the rail customer. The cost simply to file the LRS/Western Fuels complaint was $102,000, but that filing fee since has been increased to $140,600. By contrast, the cost of filing a similar case in the federal district court is $150.

In contrast to most other regulatory systems in the nation, the customer must prove first that it is subject to a railroad monopoly and then must carry the burden of proving that the rate is unreasonably high. In a normal regulatory process, the burden of justifying a rate falls on the monopoly that is being regulated. The rate reasonableness standard is not the normal: cost plus a reasonable rate of return. The rate reasonableness standard employed by the Surface Transportation Board is that the customer must prove that it can build and maintain its own railroad to move its product at a price less than the rate that is being challenged. This requires the rail customer to employ economists to construct a highly efficient “virtual” railroad that roughly follows the route and bears the same costs at the incumbent railroad. Not surprisingly, this proof is complicated and expensive. To date, LRS and its co-owners have spent $5 million on the prosecution of the rate case, which has been pending almost two years. A final judgment is not expected in this case for at least another year.

Conclusion

From the perspective of Tri-State and, perhaps, other coal transportation customers, we are faced with a national rail system that may not be able to deliver coal to our generators reliably and at reasonable costs unless changes are made. Tri-State recognizes that all rail traffic is growing and there is a need for investment in railroad infrastructure. Tri-

State supports increased infrastructure but it must come with oversight that ensures the reliable delivery of coal resources.

Tri-State recommends that the Committee and Congress pursue avenues that would ensure the reliability of coal transportation while at the same time addressing legitimate railroad infrastructure investment needs. In the Senate, we support the adoption of S.919 the Railroad Competition Act of 2005 designed to address the railroad monopoly issues that we confront today. The legislation does not address as clearly the rail delivery problems that have become acute since this legislation was introduced. The delivery problems must be addressed by Congress as well.

The railroads have suggested that the answer to current rail service and capacity problems is for Congress to enact an investment tax credit to encourage increased investment in railroad infrastructure. We could such a tax incentive if Congress coupled the investment tax credit with a defined and enforceable "obligation to serve" by the Surface Transportation Board. In addition, Congress should insist that:

- The investment tax credit must be coupled with specific provisions from S.919 and H.R.2047 that overturn the anticompetitive rulings of the STB that allow the railroads to block rail customer access to competing railroads.

- The investment tax credit must be coupled with specific provisions from S.919 and H.R.2047 that require a new rate reasonableness standard based on railroad cost of service for the movement in question, provide filing fees in line with filing fees in U.S. District Court and require the railroad to justify a rate when the complainant has proved the rate is within the jurisdiction of the STB and the complainant is subject to railroad monopoly power for the movement in question.

- The STB must require a certain level of service on railroad lines and railroads must make investments in railroad infrastructure.

We understand that legislation may soon be introduced in the Senate, providing a 25 percent investment tax credit for railroad infrastructure. This might be an ideal time for Members of this Committee to stress with the Chairman, the Ranking Member, and the other Members of the Senate Committee on Finance that no rail investment tax credit bill should move forward unless and until it contains provisions that correct the abuses of the current freight rail system.

Mr. Chairman, again I thank you for conducting this hearing today. The 1.2 million member-consumers that Tri-State serves have real concerns about our current rail service and our ability to receive reliable delivery of coal to coal generators we plan to build in the future. I would also ask that the letters from the Arkansas Electric Cooperative and BNSF that I referenced earlier be included in the hearing record, along with the recent House Subcommittee on Railroads testimony of Mr. Glenn English, CEO of the National Rural Electric Cooperative Association.