

**Federal Energy Regulatory Commission
Discussions with Utility and Railroad Representatives
On Market and Reliability Matters**

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Mr. Chairman and other members of the commission, I would like to thank you for holding today's meeting in response to the letters that we and the other electricity associations sent you last month. We appreciate the opportunity to participate in these important discussions.

The Electric Power Supply Association (EPSA) is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, and fully one-third of actual generation, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. We seek to bring the benefits of competition to all power customers.

We believe that fuel diversity is vital to best serve customers. Fuel diversity will only grow in importance as the nation embarks on the next wave of power generation. Our members operate a fleet of power plants using a diverse mix of fuels – coal, natural gas, nuclear, wind, geothermal and oil, among others. In fact, coal accounts for the largest market share among all fuels used by competitive suppliers. According to EIA data, almost 40 percent of net generation in 2004 from the competitive power sector was coal-based. In 2004, the independent power industry consumed over 222 million tons of coal, or about one-fifth of all coal production used to generate electricity.

Concerns about coal delivery by rail are not new, both as to service and rates. While the focus has been on the Powder River Basin out West, EPSA members have reported problems in the East, as well. Prior to joining EPSA last year, I was Senior Vice President of Government Affairs for the National Mining Association, where I worked closely with coal mining companies, railroads, and utilities. Senior executive-level discussions addressing coal transportation issues were held on a regular basis, and I understand the frequency of these discussions has increased along with the urgency of addressing coal delivery issues. Upon joining EPSA, I met with the business leaders of member companies to learn their concerns. Rail delivery and rate issues were high on the list of coal-fueled competitive power suppliers.

Rail transportation costs and delivery times have been an issue as long as generators have been purchasing coal. In recent years, however, rail delays have worsened in many instances, with some recent improvements. 2004 was a record rail shipping year, with much-publicized national angst over delivery problems threatening both coal stockpiles and Christmas shoppers. Maintenance issues led to a rail outage in the Powder River Basin in 2005, causing shortages and forcing some power companies to buy more expensive replacement power when they couldn't get enough coal to run at full capacity. This year, reports of congestion problems continue for specific power plants, and railroad fuel surcharges are contributing to higher electricity costs and thus higher rates. Nevertheless, we are not here to point the finger of blame. This specific issue illustrates a broader national challenge – the importance of working together across industry sectors and government agencies on practical solutions to pressing problems.

I have heard the argument from our railroad colleagues that the construction of natural gas plants in the 1990s sent the signal that additional investment in rail infrastructure for coal deliveries was not warranted. That argument would be valid if today's rail coal delivery problems were impacting recently constructed coal plants. In fact, few new coal plants were built. The plants experiencing coal delivery shortfalls today are among the same plants that have been around for years.

While coal tonnage consumed in power generation has increased over time due to greater use of low sulfur, but lower heat content western coal, the increase has been predictable and relatively gradual. According to the most recent Quarterly Coal Report of the Energy Information Administration (EIA), there was only a seven percent increase in coal consumption from 2001 to 2005 – gradual and in line with historical averages. The domestic mining industry has increased production to meet this demand and is capable of continuing to do so. The bottlenecks in the capacity of our transportation system to deliver coal as needed at reasonable rates cannot be explained by the use of natural gas in new generation.

Congress recognized coal's role in our national fuel mix in the Energy Policy Act of 2005. This law created a strong clean coal program, including tax incentives, grants and loan guarantees to encourage the construction of clean coal facilities. EPSA members are eager to participate in the development of innovative new coal generation, but we need access to both coal and open, regional electricity markets with a strong transmission system to allow consumers to benefit from these advances.

Rail Delivery Shortfalls and Their Impacts

We would like to detail some of the rail delivery problems reported by EPSA members in order to then work together to craft long-term solutions to facilitate fuel diversity as we meet the growing demand for electricity projected for coming decades.

Many power generators are concerned that the limited number of Class I railroads are unable to keep up with demand for timely rail service, and instead are giving greatest priority to the rapidly growing and highly remunerative intermodal shipment market over coal deliveries. While the overall summer power supply outlook is favorable, rail delivery issues potentially imperil electric reliability by leading to lower coal inventories at specific locations. However, the reliability impact is greater over a longer planning horizon unless steps are taken to facilitate the projected increase in coal use going forward.

One of the policy rationales for increased coal use is that coal is a domestic fuel. While the U.S. has 250 years of coal at current consumption rates, that doesn't mean much if we can't get the coal to market. Coal imports into the U.S. actually increased 11.7 percent from 2004 to 2005. According to the EIA, some of this increase is attributable to the internal coal transportation problems experienced during the year. The use of imports to address rail delivery concerns is confirmed by reports from EPSA members. The average price of U.S. coal imports increased by 24.5 percent to a level of \$46.71 per short ton. The overall average delivered coal price for the power industry was \$30.26 per ton – imported coal is not cheaper, but it gives coastal facilities a more reliable source of supply. Unfortunately, a number of our companies have reported that it is difficult or impossible to get reasonable rates (or any service at all) to bring imported coal inland via rail. Based on conversations with EPSA members, I can also report the following:

- Generators have invested heavily in their own railcars, because the railroads have been unable to provide enough cars. Railroads in some instances are now refusing to carry these generator-owned cars, or parking them for extended periods of time, further jeopardizing coal inventory at affected power plants.

- Due primarily to delays in rail delivery times for Western coal, one of our member's plants was faced with the possibility of five days or less of stockpiled coal. They were forced to purchase and import 95,000 tons of South American coal to avoid curtailing operations and thus continue to serve customers.
- One of our companies tried to get rates to transport coal inland from import terminals on the East Coast, and the only railroad with a line to do so has simply refused to quote them.
- An EPSA company wanted to do a test burn of Powder River Basin coal in one of its plants, and was told by the railroad that they couldn't hope to get a delivery until well into 2007.
- One member has traditionally burned Central Appalachian coal in its East Coast plant. In the last two to three years, domestic rail delays have forced them to rely increasingly on imported coal – they now import about 30 percent of their coal from Colombia.
- One company was importing South American coal into the Texas Gulf Coast, but the railroad would not perform any deliveries from the entry point to their plant due to congestion.

Fuel Surcharges and High Rail Rates Impose Further Costs on the Power Sector

Class I railroads are currently applying a fuel charge in some form, depending on the specific contractual arrangement between the railroad and the shipper. Some of these fuel charges are included as part of an agreed upon contract to reflect recent increases in fuel costs – about which we as generators are very familiar, as rising fuel costs are the principal reason why electricity rates are increasing across the country. In other instances, however, these costs are added as a surcharge to a pre-existing tariff. Projects with expiring contracts are also being burdened with as much as a 40 percent increase in transportation costs as fuel adjustment clauses are added to their new contracts.

While we acknowledge that fuel prices have increased in recent years, these surcharges are added to a railroad's rate tariff, which includes a Rail Charge Adjustment Factor (RCAF). The RCAF reflects certain increased costs on a quarterly basis. A component of the increases is reserved for fuel adjustments. For those rail customers operating under a tariff that includes the RCAF, any additional fuel surcharge is simply double counting and, hence, over-recovery.

The supplemental surcharge is included without any stakeholder input, much less regulatory oversight and approval. This type of surcharge puts an undue financial burden on generators that eventually gets passed on to power customers.

- One of our member's plants has been faced with a 66 percent rail rate increase in two years, including the fuel adjustment costs. This is a factor in their planned retirement of the plant.
- A plant which gets much of its coal from West Virginia has faced higher and higher fuel surcharges, which appear to have no direct relationship to the railroad's actual fuel costs to serve the plant. Rail delays are also causing great concern for this plant.

The Future of Coal: FERC Can Take Action to Improve Access

We believe that coal will continue to be a fundamental energy source for our country. The Energy Information Administration's 2006 Annual Energy Outlook predicts a base case scenario of 350 gigawatts of new generation needed by 2030; almost half of this, 174 gigawatts, is forecast to come from coal. At the same time, coal-to-liquids and new generation will represent 76 percent of the increase in demand for coal from 2004 to 2030 – with EIA projecting that much of this development will occur at facilities which are built near coal mines. This is where FERC can play a vital role. The nation's transmission grid – in terms of investment and open access operation – will need to be ready to get that electricity from mine-mouth to load. Independent generators are eager to take part in this increased coal production – we'd like to develop new technologies, bring jobs to mining regions, and sell affordable, reliable power to consumers. In order to do this, we need your help ensuring an open and reliable transmission grid and functioning wholesale competitive markets. The U.S. may be the much-touted Saudi Arabia of coal, but we need the electric transmission equivalent of Germany's autobahn if consumers are to truly benefit from America's domestic coal resources.

If the transmission grid and regional electricity markets are vibrant and accessible, sources of electricity generation will be equally accessible and supplied by diverse fuel sources. Full and open access to the grid will reduce or eliminate problems stemming from over-dependence on fuel delivery mechanisms, whether rail, barge or truck, to transport coal to distant power plants. Better regional access to electricity markets is essential to the development of mine-mouth coal plants, bypassing the need for rail deliveries of coal. Further, a framework that ensures better transmission access to the grid by diverse generation sources will exert competitive pressures on the railroad companies to improve their delivery service and availability. The more options generation sources have for input onto the electricity grid, the less of a hold one particular fuel delivery mechanism will be able to exert over generation options. If plant-specific delivery problems arise, robust wholesale markets minimize the impact on consumers by making other supply options more readily available.

The Commission is currently addressing these issues on several fronts - reforming the Order 888 Open Access Transmission Tariff to ensure real and meaningful access by competitive suppliers and transmission-dependent customers; discussion of pricing incentives to support transmission expansions and infrastructure investment; the development of a national electric reliability organization to ensure that reliability is maintained and largely standardized across the entire transmission system; and the upcoming proposed rule for federal backstop transmission siting authority. These efforts are of the utmost importance because they will help broaden and strengthen the entire electric delivery chain.

Further, the transmission access and wholesale electricity markets improved by these efforts will bring the certainty needed to underpin the construction of the next wave of power generation. If the EIA's Annual Energy Outlook 2006 is correct, we have our work cut out for us. Where this new generation will be sited and which fuel sources will be utilized are questions that must be answered today in order to get generation online as it is needed over the next 25 years, with some predicting regional shortages as soon as next year and 2008. While coal delivery issues will be a part of the mix of considerations, accessibility by *all* to the transmission grid will allow for competition to deliver a diverse mix of supplies, based on fuel and plant location, so that no one plant has a disproportionate impact on reliability.

As coal delivery will remain an important component of electric reliability even with open access reform, we urge you to work with the Surface Transportation Board (STB) to address our industry's concerns. FERC should publicly monitor rail and coal issues, as you have done successfully for months on natural gas. The STB should be encouraged to take a harder look at market power issues just as FERC is doing in the electric sector, rather than focusing solely on railroad cost recovery. Fuel surcharges should be more transparent and based on actual increased fuel costs which are not included in the Rail Charge Adjustment Factor (RCAF). The railroads need to focus capital on relieving the areas which are the most congested. Transportation rates and terms for imported and domestic coal need to be harmonized, to increase competition and vary the supply sources for coal. Rail capacity in the Powder River Basin and on routes leading from the area to the rest of the country should continue to be expanded.

Again, we appreciate you and your staff taking the time to look at the coal delivery issue through this public forum. We look forward to continuing to work with you to address the needs of electric power customers now and in the future.