

**UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 670

***ESTABLISHMENT OF THE
RAIL ENERGY TRANSPORTATION ADVISORY COMMITTEE***

**COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY**

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Dated: April 16, 2007

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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Norfolk Southern Railway Company (“NS”) hereby submits its Comments on the STB’s March 9, 2007 Notice in STB Ex Parte No. 670 regarding the establishment of a rail energy transportation advisory committee.¹

Although NS does not think such a committee is needed, if the Board establishes such a committee, it offers the following suggestions:

- Membership should include representatives of various energy sources for which rail is only part of the supply chain, including coal, ethanol, and nuclear;
- Membership should include representatives from across the supply chains;
- Membership should be limited to actual companies involved in the respective supply chains for these sources of energy, not industry associations; and
- Agenda topics should be restricted to issues that will not raise antitrust issues for any participants.

¹ See Decision in STB Ex Parte No. 670, *Establishment of the Rail Energy Transportation Advisory Committee* (served Mar. 9, 2007) (“Decision”).

I. NS Coal Transportation Remains Reliable.

NS has successfully provided reliable, efficient, and safe service to our utility customers. Last year, NS appeared at a workshop hosted by the Federal Energy Regulatory Commission, and the written comments NS submitted for that workshop are attached as Appendix A. Several of the successes discussed in those comments are worth highlighting.

- In each of 2004, 2005, and 2006, NS set new records for the number of tons of coal transported to its utility customers.
- Growth in NS deliveries to utility plants has exceeded the rate of increase of coal-fired generation in the NS service region.²
- Growth in NS coal volume has consistently surpassed the growth in coal production for each major coal-producing region.

NS has had this success despite the shifting transportation patterns that have emerged in recent years. Utilities have been shifting their strategies for where they purchase coal often on short notice. For example, since 2003, the volume of coal NS has shipped from the Central Appalachian region has decreased 11%. Coal shipped from other origins has increased 32% over the last three years. In each of 2004, 2005, and 2006, the amount of coal interchanged to NS from another railroad increased year-over-year by 19.2%, 13.9%, and 28.9%, respectively.³

Moreover, there are several groups and councils that already bring stakeholders in energy transportation – particularly coal transportation – to discuss issues

² In 2004, coal-fired generation in the NS service region increased 1.5%, but the volume of coal received at NS-served utilities increased by 3.4%. Similarly, in 2005, coal-fired generation grew 3.4%, while NS increased its deliveries to utilities by 6.3%. The trend continued in 2006 when coal fired generation grew 1.1%, but NS utility volumes increase 3.9%.

³ Infrastructure added by railroads based on shippers historic shipping patterns or the representations of shippers about their expected shipping patterns, will not be of much help if shippers suddenly change their shipping patterns.

affecting the supply chain. Some of these groups meet a few times a year, while others meet more frequently. NS actively participates in these groups and councils.

Finally, as was highlighted at the Board's April 11, 2007, hearing on capacity and infrastructure, it takes time and money to expand capacity and to add infrastructure. But that expansion is critical to coal service. Foundation Energy Sales, Inc., noted that its testimony about coal service "points to the need for railroads to have additional infrastructure and resource capability in order to provide consistent and reliable service."⁴ The Concerned Captive Coal Shippers similarly stress the importance of infrastructure on coal transportation:

It is critical, of course, that the railroads maintain adequate capacity and infrastructure to transport coal to utility power plants. . . . coal shippers are dependent upon rail carriers to provide needed coal transportation service, and disruptions in this service due to inadequate capacity can impose substantial damages upon electric generating utilities and their customers.⁵

Thus, the ability of railroads to transport coal or other energy-related materials is really encompassed by the larger issue that was the subject of this recent hearing.

II. If Created, the Committee's Membership and Agenda Should Be Tailored to Achieve the Board's Objectives.

NS does not believe the proposed committee is necessary. If the Board is nevertheless inclined to create a rail energy transportation advisory committee, the Board should carefully consider the membership and agenda for the committee so that the

⁴ Written comments of Foundation Coal Sales, Inc., Ex Parte 671, *Rail Capacity and Infrastructure Requirements*, at 4-5 (submitted April 4, 2007).

⁵ Written comments of Concerned Captive Coal Shippers, Ex Parte 671, *Rail Capacity and Infrastructure Requirements*, at 11 (submitted April 4, 2007).

committee can achieve the Board's objectives. In particular, NS offers the following four suggestions.

First, membership should include representatives of various energy sources, including coal, ethanol, and nuclear. Although the rail transportation for coal utilities and of ethanol are widely known, rail plays an essential role in other segments of the energy sector. For example, rail is important to the construction of nuclear power plants, for which railroads transport component parts of nuclear reactors, and to the disposal of spent nuclear fuel. For the Board to have a complete picture of rail's role in the nation's energy supply chain, these diverse energy interests should be represented.

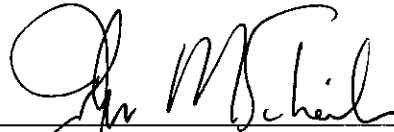
Second, membership should include representatives from the entire supply chain for the various energy sources. The supply chain does not consist only of railroads. As the National Coal Transportation Association commented recently, "The producers, utilities, and carriers are inextricably locked together with each being the legs of a triangle."⁶ The coal mines that supply the coal and that to a large degree control the availability of coal and the loading of coal into rail cars are an important link in the chain for coal-fired utilities. The utilities themselves are an important component of whether the supply chain is working well because changes in their shipping patterns and in their policies regarding the appropriate level of stockpiles directly affect the chain. Similarly, the nuclear power plants are an important link in the chain for utilities generating nuclear power. Because every link is critical, the membership of any advisory committee should reflect the entire supply chain.

⁶ Written comments of National Coal Transportation Association, Ex Parte 671, *Rail Capacity and Infrastructure Requirements*, at 2 (submitted April 4, 2007).

Third, membership should be limited to companies that are in the supply chain, not industry associations. The Board's stated goal is for the committee to provide "independent, candid policy advice to the Board." Decision at 2. Individual companies that are engaged in the day-to-day businesses that affect rail energy transportation are in a better position to give independent, candid advice. That is why the Board's Rail Shipper Transportation Advisory Committee, for example, does not have associations as members. The Board will be better served by a committee comprised of representatives of companies that participate in the supply chain day-to-day, that decide what types of energy investments to make, that purchase rail transportation services, and that make decisions regarding rail investment.

Fourth, the agenda of the committee must be limited to avoid potential antitrust issues because many of the potential representatives will come from competitors within the same industry. To some degree, virtually every representative can be a competitor because everyone will be involved in the production of energy.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "John M. Scheib", is written over a horizontal line.

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APPENDIX A



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Dear Commissioners:

Thank you for the opportunity to present the facts about the performance of Norfolk Southern to our utility customers.

By almost any measure, NS has successfully provided reliable, efficient, and safe service to our utility customers during this period of unparalleled demand for steam coal. Our ability consistently to set new annual, quarterly, and monthly records for coal delivery to our utility customers since 2004 is even more impressive given that the utility industry sent clear signals in the preceding years that it was shifting away from coal in favor of natural gas for electricity generation. Consider the following:

- Growth in NS deliveries to utility plants has exceeded the rate of increase of coal-fired generation in the NS service region.
- As a result, NS-served utilities have seen a 70% increase in destination stockpiles since mid-2004.

- Growth in NS coal volume has consistently surpassed the growth in coal production for each major coal-producing region.
- NS has achieved these positive results despite utility decisions to drastically shift coal-sourcing strategies.
- NS has invested heavily in its coal network in recent years as gas prices climbed and utility customers abandoned their gas-generation strategies and returned their emphasis to coal.

The reliability of coal delivery depends upon each link in the supply chain. Coal availability, railroad performance, and a utility's decision to accept and dump trains on a ratable, timely basis are all factors that affect this reliability. Each link should be considered when examining coal-delivery matters and their impact on markets and electric reliability. Communication among the three links is essential to resolve issues and avoid often unsubstantiated finger-pointing. Norfolk Southern fully recognizes its important role in the supply chain. Given that NS' growth in delivered coal volumes exceeds both the growth in coal produced and the growth in coal burned, it becomes abundantly clear that NS has acted as a beneficial member of the supply chain, providing the opportunity for utilities to rebuild stockpiles and reach for alternative sources of coal.

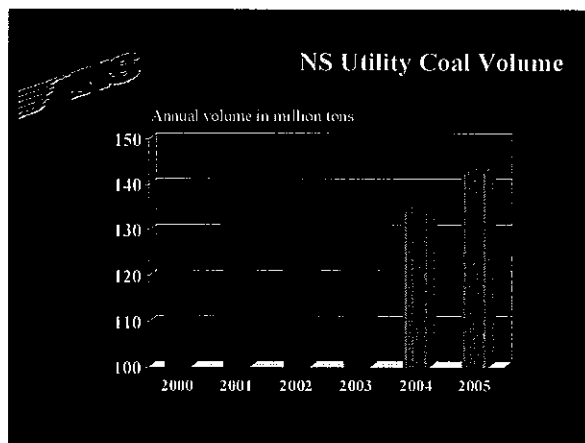
Record Volumes

Driven by robust demand for steam coal, NS set a new record for coal, coke and iron ore traffic in 2005 with a 3.0% increase in volume over 2004. It is noteworthy that 2004 itself was a

record-setting year for coal, coke and iron ore volume, surpassing the previous mark established in 2001. In March 2005, NS set a monthly record for total coal, coke and iron ore volume which has been exceeded four times in the last ten months. High demand continues this year as NS has managed year-over-year increases in coal, coke and iron ore volume in eight of the last nine quarters, and in May 2006, NS established new monthly tonnage records for utility coal and total coal, coke and iron ore.

Utility Deliveries Exceed Generation Growth

NS coal volume to utility plants fluctuated greatly at the beginning of the decade, rising from 119.4 million tons in 2000 to 132.3 million tons in 2001 before dropping to 127.7 million tons in 2002. As national demand for utility coal accelerated in 2004, NS deliveries followed suit with NS setting a new record for utility volume in 2004 only to increase that figure by 6.3% in 2005.

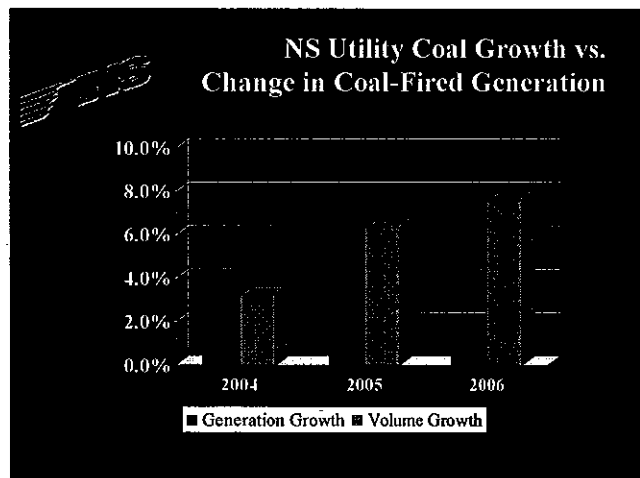


NS transportation of utility coal has continued to strengthen in 2006. Through the first five months of the year, NS utility volume has surpassed 2005's record-setting pace by 7.6%. NS deliveries to utility plants have exhibited year-over-year growth in seven consecutive quarters.

Year-end coal stocks for electric power generators decreased from 141.7 million tons in 2002 to 121.6 million tons in 2003¹. This inventory reduction of over 20 million tons represents the largest annual decrease in the last five years.

While NS did experience a slight increase in utility demand in 2003, it should be noted that NS regularly had surplus rail cars in storage during this period, including over 5,300 cars at one point in the year. While not a regular occurrence in 2003, NS also placed surplus locomotives in storage during periods of low demand. Paradoxically, NS was forced to idle surplus coal-carrying capacity concurrent with the largest decrease in utility stockpiles over the past five years. As recently as 2001, two prominent executives from NS-served utilities informed NS that they would invest heavily in natural gas plants, supplanting coal-fired generation. This business decision by utilities and the explicit threat regarding the importance the utilities placed on coal transportation capacity made the requirement to store surplus capacity more alarming.

Since the start of 2004, NS-served utilities have enjoyed increased coal receipts that have outpaced the growth in coal-fired electricity generation in the NS service region. Coal-fired generation in the NS service region increased 1.5% in 2004², which was surpassed by the 3.4% growth in NS utility volume during the same



¹ Source: US Energy Information Administration

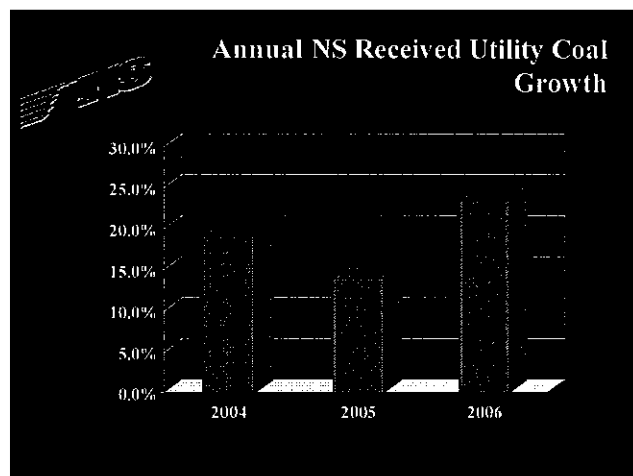
² Source: US Energy Information Administration

period. Similarly, coal-fired generation grew 3.4% in 2005³ while NS increased its deliveries to utility plants by 6.3%. The same relationship continues in 2006 as NS utility volume has increased 7.6% compared to a 1.3% increase in coal-fired generation⁴.

Adaptability to Coal-Sourcing Shifts

The NS response to increasing demand for utility coal is not simply measured in terms of increasing volume. In addition, NS transported coal from non-traditional origins as utilities shifted sourcing strategies. The result is that while NS Central Appalachian volume to the utility market has decreased 12% since 2003, utility coal from other origins has increased 25% over two years. The consistent ability of NS to handle volume increases from non-traditional origins that exceed the growth in coal-fired electricity generation has benefited our customers and resulted in improved stockpiles at NS-served utility plants.

As evidence of the efficient coordination with other Class I carriers, the amount of coal originated on these railroads and interchanged to NS for delivery to utility plants continues to exhibit significant annual growth. The sourcing shift began in 2004 with a



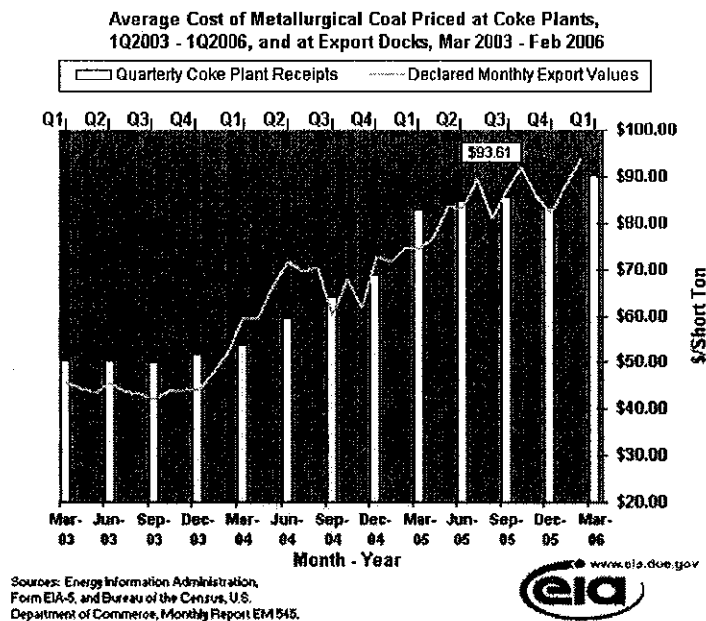
³ Source: US Energy Information Administration

⁴ Source: Genscape

19.2% increase surge in this received traffic. Further increases were handled in 2005 as received coal grew by 13.9%. The start of 2006 has proven vigorous as received coal moving to the utility market has increased by 23.4%. Over the last 30 months, NS has managed 68% growth in received coal traffic, a substantial sourcing shift that has been accommodated by NS.

Much of the driving force behind the sourcing shift was the imbalance of supply and demand for Central Appalachian steam coal in 2004. This was initiated by continued production decreases as Appalachian coal production in 2003 declined to its lowest level in 25 years when a 1978 United Mine Workers of America strike limited production⁵. The production decrease was compounded by a cross-over of steam coal to steel-making use as a result of increasing demand for metallurgical coal in 2004. The average price of metallurgical export coal increased from approximately \$45/ton in December 2003 to \$72/ton at the end of 2004⁶. This 60% increase in coal price prompted many

producers to shift high-quality steam coal to the metallurgical market. Central Appalachian steam coal originations on NS decreased by 6.7 million tons while metallurgical volume simultaneously increased by 2.7 million tons. Over the NS system, 2004 shipments of



⁵ Source: US Energy Information Administration

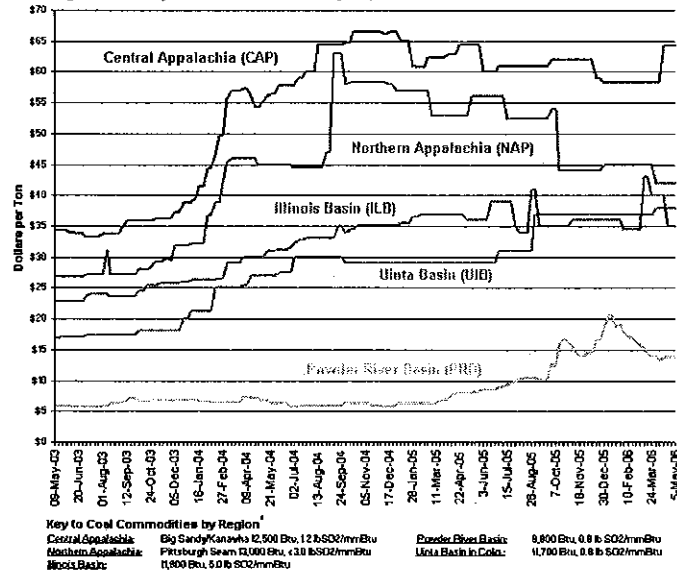
⁶ Source: US Energy Information Administration

metallurgical coal increased by 24% despite extended outages at the two largest metallurgical mines served by NS.

NS continues to be proactive when there are delivery concerns at utilities, establishing a procedure of conference calls involving mines, the utility and NS. This forum of discussion isolates issues as relating to mine, utility or NS performance and serves to minimize hyperbole regarding the causes for delayed shipments.

Further evidence that demand for steam coal outstripped supply in 2004 is seen in the spot price for Central Appalachian steam coal, which essentially doubled in 2004⁷. As a result, utilities were forced to extend their reach for coal as NS length-of-haul increased.

Average Weekly Coal Commodity Spot Price

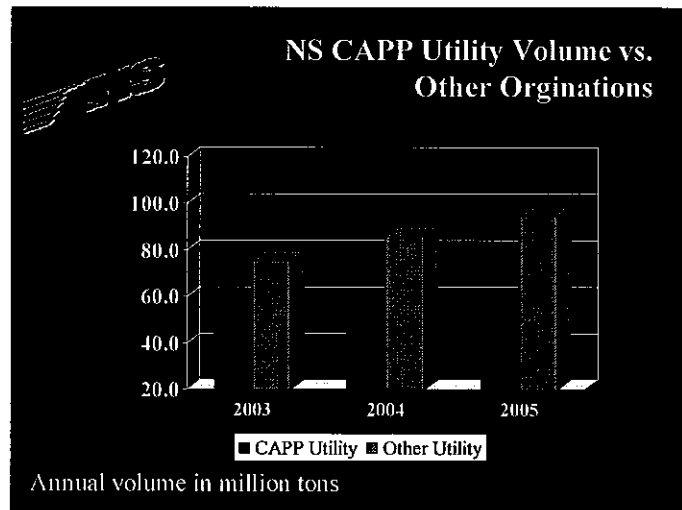


Source: EIA

In addition to increasing demand for PRB and Northern Appalachian coal, NS utilities began testing import coal in 2005 as a replacement for traditional Central Appalachian coal supplies. In many cases, the length-of-haul for the PRB and import coal exceeded the distance required to

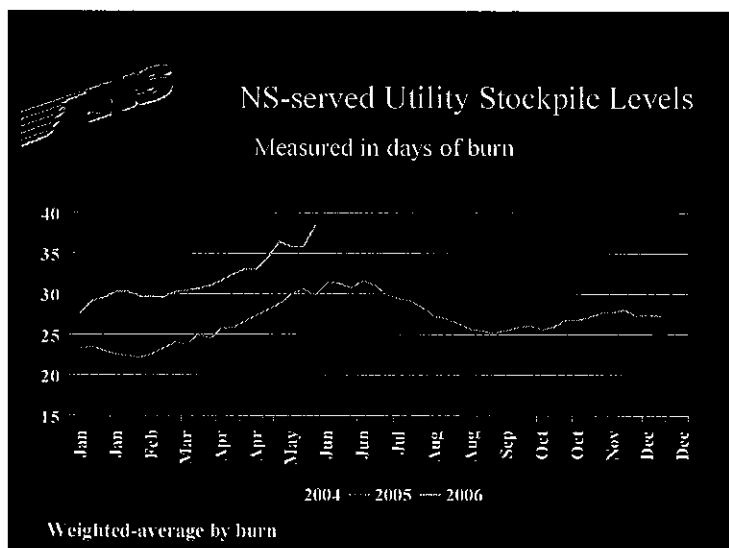
⁷ Source: US Energy Information Administration

transport the Central Appalachian coal it replaced. The average length-of-haul for privately-owned utility sets on NS increased by 12% from 2003 to 2005 while loads increased 17%; similarly, length-of-haul in NS equipment increased 9% in 2004. This underscores the fact that NS has handled more coal to its utility customers over a greater distance in lanes that were not originally designed to handle that volume.



Increasing Utility Inventories

With the pace of utility deliveries continuing to exceed the growth in coal-fired generation, NS has seen a corresponding increase in utility stockpiles. Based on information provided by our customers, stockpiles at NS-served utilities have increased by over 70% since July 1, 2004. Similarly, inventories at over 90% of the NS-served utilities have increased since July 1, 2004, and compare favorably to levels reported in June 2001.



The comfort level of NS-served utilities with their inventory level has resulted in several major utilities neglecting the opportunity to take additional coal deliveries in the past twelve months. There are eight major NS-served utility plants with aggregate stockpiles in excess of 40 days compared to two plants with stockpiles below 20 days. One of these two plants maintains an inventory target below 20 days while our customer advises deliveries to the other plant have been impacted by a dumper outage and non-NS service issues.

Outpacing Coal Production

In addition to outpacing the market for coal-fired generation, the growth in NS coal volume has also exceeded the increase in coal production. For 2004, NS coal volume increased by 6.1%. As noted on the graph prepared by the US Energy Information Administration, the 6.1% growth handled by NS in 2004 exceeded the production growth for each of the three major coal-producing regions in the United States.

Comparisons continued in 2005, when NS coal volume increased 4.1%, exceeding 1.7% production growth in Appalachian coal and the 2.1% increase in both Interior and Western coal.

With respect to specific regions for NS-originated coal, NS Northern Appalachian originations increased by 6.6% in 2005, comparing favorably to a 1.5%-increase in Northern Appalachian production⁸. Similarly, Central Appalachian volume on NS was flat in 2005, while Central Appalachian production declined by 1.5%⁹.

⁸ Source: US Energy Information Administration

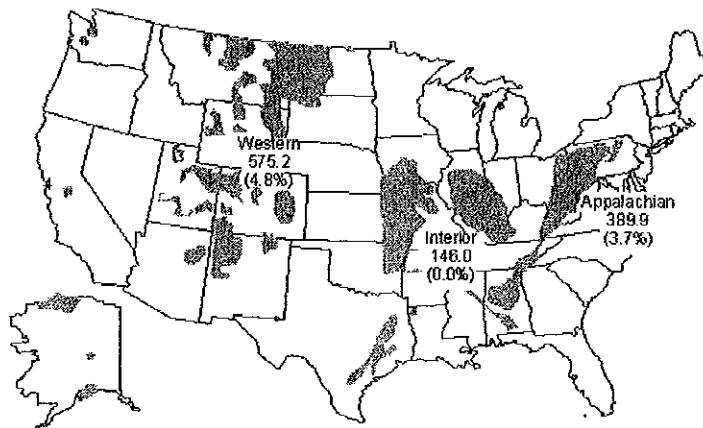
⁹ Source: US Energy Information Administration – Includes Eastern Kentucky, Southern West Virginia, and Virginia.

The consistently demonstrated ability of NS to outpace growth in coal-fired electricity generation and coal production has provided our utility customers with the opportunity to shift origins and rebuild stockpiles and benefited our originating customers by extending the

market reach for the producers' coal. Brett Harvey, President and CEO of CONSOL Energy Inc., the largest producer of high-Btu bituminous coal in the United States and the largest producer on NS, stated in

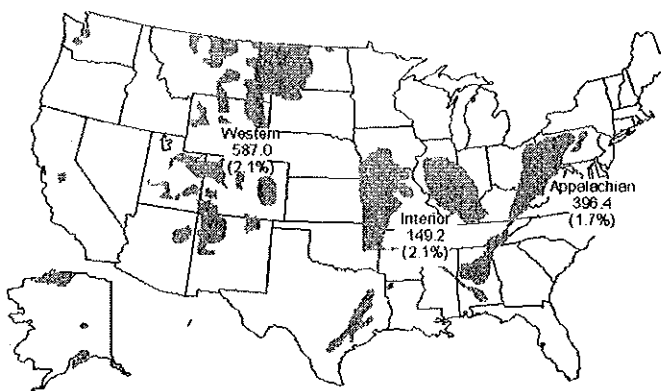
April that "the transportation system has been very reliable for us during this past quarter."¹⁰ In the same conference call, Harvey stated, "Transportation systems are working well for us, and in all regions we're satisfied with our service there."

Coal Production by Coal-Producing Region, 2004
(Million Short Tons and Percent Change from 2003)



Sources: Energy Information Administration, Annual Coal Report, 2004, DOE/EIA-0584(2004) (Washington, DC, September 2005).

Coal Production by Coal-Producing Region, 2005
(Million Short Tons and Percent Change from 2004)

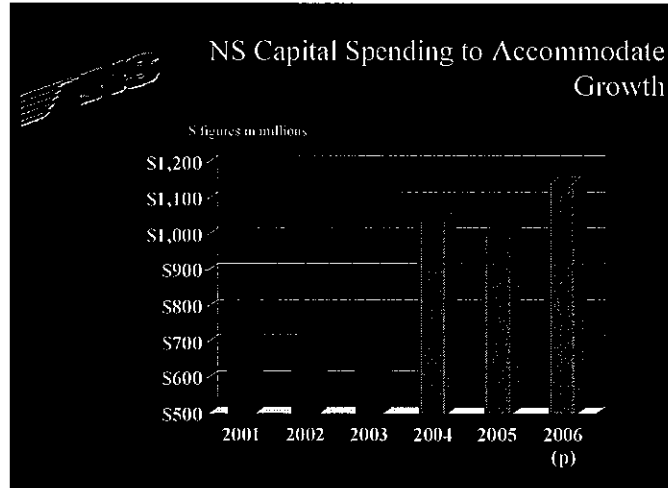


Source: Energy Information Administration, Quarterly Coal Report, October-December 2005, DOE/EIA-0121(2005/Q4) (Washington, DC, March 2006).

¹⁰ CONSOL Energy Inc., First Quarter Conference Call – April 27, 2006

Investment to Accommodate Growth

NS' ability to accommodate this flexibility is the result of sustained and escalating investment in our coal franchise. NS capital investment has grown substantially in the last three years, increasing by approximately 60% since 2003. In 2006, NS initiated capacity improvements between Memphis and Macon, Georgia, totaling \$60 million that will improve the fluidity of PRB, Colorado, and Illinois Basin coal moving into the Southeast. This year, NS expects to complete a \$42 million project that will improve access into a coal-fired power plant, reducing transit time and allowing for longer trains. In 2007, NS expects to take delivery of 1,700 high-capacity coal cars that will improve the efficiency of deliveries to NS-served power plants.



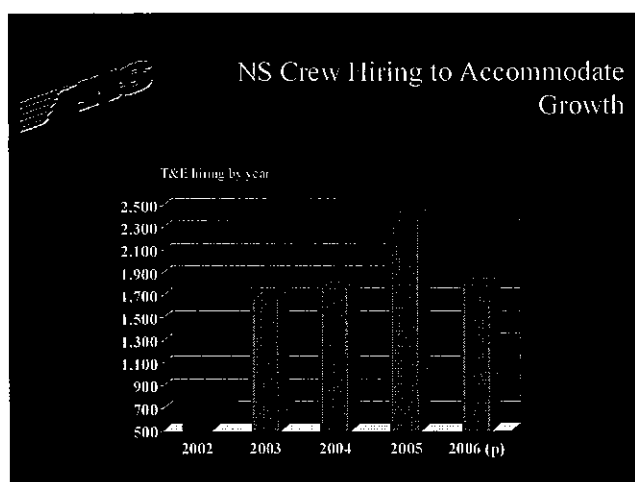
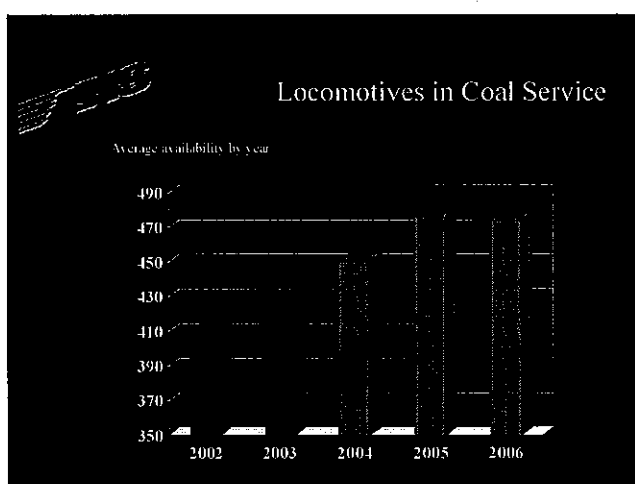
NS continues to work closely with mines to invest in the installation of new facilities, providing our utility customers with access to additional coal. Furthermore, NS assists mines with upgrades to more efficient coal loadouts and utilities with coal-handling systems that allow for increased capacity. Efforts continue to encourage our utility customers to utilize more efficient coal cars, thereby adding capacity.

Investments have included locomotives to handle the growth in coal volume. In 2004, the original capital budget included 100 locomotives. As it became apparent that demand would exceed forecast, NS added 107 locomotives to the capital acquisition plan for 2004. Similarly in 2005, NS increased its order for locomotives by 52 units in the face of continued growth. From 2004 through the end of this year, NS plans to add over 400 locomotives to its road fleet.

Additionally, in 2005, 491 existing locomotives were overhauled and 29 were rebuilt; another 420 will be overhauled and 52 rebuilt in 2006.

Additionally, NS is equipping some of its locomotives with distributed power in an effort to reduce transit times and increase train sizes for moves to specific coal-fired power plants.

As a result of the investment in locomotives, the number of units in coal service has continued to climb, improving fluidity for coal traffic and accommodating our utility customers' need to diversify their coal-sourcing portfolio.



Additionally, NS has accelerated crew hiring to handle the increased volume. Over the last four years, the average annual hiring has more than doubled the crew hiring required in 2002. Note that NS increased its hiring program in 2003, in advance of the significant traffic increases that we experienced in 2004.

Communication Required

With investment and advance planning, NS positioned itself to handle the increased and shifting demand placed by our customers as evidenced by increasing utility volume, considerable growth in PRB coal, longer hauls and increasing utility stockpiles. To ensure that NS has the resources in place to handle future volume increases and sourcing shifts, NS-served utilities will need to communicate their plans in advance. At a minimum, the planning horizon for crews, cars, locomotives and track capacity is one year and can reach three years depending upon the circumstance. Investment of crews and track capacity is lane-specific and requires knowledge of specific volume changes.

Communication is essential and NS investment will continue to take its lead from the feedback we receive from our customers. In closing, the following quote from Charles W. Moorman, Norfolk Southern Chairman, President and Chief Executive Officer, emphasizes the importance of communication: "There never has been a more important time for Norfolk Southern and its

customers to talk plainly about expansion plans, coal forecasts and coal purchasing decisions that drastically shift tons to new lanes.”¹¹

Daniel D. Smith
Senior Vice President Energy & Properties
Norfolk Southern Corporation

¹¹ Speech to the Center for Energy and Economic Development – September 23, 2005.