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July 5, 2007

VIA ELECTRONIC FILING

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0001

Re: *Rail Transportation Of Resources Critical To The Nation's Energy Supply*
STB Ex Parte No. 672

Dear Secretary Williams:

Pursuant to the Surface Transportation Board's ("Board") June 6, 2007 decision in the above captioned proceeding, enclosed for filing with the Board is the written testimony of Mr. Daniel Avramovich, Executive Vice President Sales and Marketing, The Kansas City Southern Railway Company ("KCSR"). If there are any questions concerning his written testimony, please contact me at the address and phone listed above or at wmullins@bakerandmiller.com.

Respectfully submitted,



William A. Mullins

cc: Mr. Daniel Avramovich
Mr. Warren Erdman
Mr. W. James Wochner

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 672

**RAIL TRANSPORTATION OF RESOURCES CRITICAL
TO THE NATION'S ENERGY SUPPLY**

WRITTEN TESTIMONY OF

DANIEL W. AVRAMOVICH

EXECUTIVE VICE PRESIDENT SALES & MARKETING

THE KANSAS CITY SOUTHERN RAILWAY COMPANY

JULY 5, 2007

**DANIEL W. AVRAMOVICH
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My name is Daniel Avramovich, and I am the Executive Vice President for Sales and Marketing for The Kansas City Southern Railway Company (“KCSR”). I am pleased to submit these written comments on behalf of KCSR in response to the Surface Transportation Board’s (“STB” or “Board”) announced hearing on the subject of the efficiency and reliability of the rail transportation of resources critical to the nation’s energy supply, including coal, ethanol, and biofuels. To date, KCSR has had relatively limited experience with the transportation of ethanol and biofuels. While we fully expect (and hope) that KCSR’s participation in the movement of ethanol and biofuels will grow significantly in the future, our limited experience to date does not give me a sufficient factual basis to feel comfortable in expounding upon the supply-chain characteristics and infrastructure needs associated with the transportation of ethanol or biofuels.

In contrast, KCSR’s transportation of coal for use by the electricity-generating industry represents 22.8% of KCSR’s 2006 volume and 15.9% of KCSR’s 2006 revenues. Accordingly, my statement will focus on the coal transportation, and KCSR’s role in ensuring adequate power generation.

To put KCSR’s coal transportation services in perspective, we handle approximately 8.5% of all coal originating in the portion of the Powder River Basin that is served jointly by BNSF Railway Company (“BNSF”) and the Union Pacific Railroad Company (“UP”). Virtually all of that coal is delivered to us at Kansas City, MO. From there, KCSR transports it to consumers (power plants, predominantly) located on KCSR’s system. Thus, KCSR is a terminating carrier only for coal, unlike the larger Class I carriers located to the east and west of KCSR’s system, all four of which originate *and* terminate coal.

It is my hope that this hearing will create a meaningful dialogue between railroads and energy-oriented shippers, and that it will not be reduced to an airing of grievances where the stakeholders on either side of the equation talk past each other. While the rail and the utility industries seem too often to be at odds before this particular body, there are many things upon which both sides of the discussion can and do agree. Among these is that the recognition that efficient and reliable transportation of coal is vital to the economic health and energy security of the United States. While trucks and barges certainly play a role in the transportation of coal, railroads today are the clear leaders in the transportation of coal. Indeed, we in the rail industry often work alongside the coal and utility industry to encourage government policies which would promote the use of coal and to discourage policies which would increase the costs to the industry. In this sense, we are partners working together.

Yet, when one focuses solely on the rail component of this coal-power generation supply chain market, railroads often are no longer spoken of by the utility industry as partners, but rather as adversaries – as asserted monopolists abusing market power. This is unfortunate. As noted, we all play a role in the entire supply chain necessary for ensuring efficient and adequate power generation. As such, KCSR recommends that any examination of energy transportation, particularly coal generation, must include an examination of the loading and unloading capabilities at both origin and destination, as well as the marketing, pricing, and inventory policies in the utility industry itself. While such a comprehensive examination is beyond the scope of KCSR's small role in the overall power generation supply-chain, I suggest that the STB cannot truly "examine

issues related to the efficiency and reliability” of the rail transportation of critical energy resources without a comprehensive examination of all components of the supply-chain.

Nonetheless, focusing on KCSR, there are two elements necessary for KCSR to maintain and improve the efficiency of its coal movements. First, KCSR must earn revenues adequate to attract the capital necessary to support infrastructure improvements. As with all other major railroads, KCSR has seen, and anticipates, growing demand for rail transportation, not merely in the energy sector but across virtually all commodity groups. To meet such growing demand, and to do so ever more quickly to sustain efficient operations, railroads must attract adequate capital, which means, by its very nature, that railroads must maintain profit levels satisfactory to investors. In this regard, KCSR is challenged to attract investment and to spend wisely on infrastructure to ensure continued adequate returns in the future. Second, as I have indicated above, government policies must encourage the efficiency of the overall coal transportation network, and not focus exclusively on the rail component of that network.

As to the first point, there is no doubt that increased revenues means increased investment into the network. Our record reflects that, as revenues have increased, we have put more and more back into infrastructure and equipment. Indeed, over the past few years, KCSR has invested more in infrastructure than ever before. Yet, this won't continue if KCSR is faced with laws, regulations, or policies that artificially cap revenues or prevent KCSR from covering its fully-allocated costs and earning its cost of capital. To be viable and effective in the years ahead, especially in the face of projected huge increases in transportation demand, KCSR must be able to maintain and replace its

existing infrastructure and equipment *and* build the substantial new capacity required to handle such traffic growth.

As long as the regulatory and economic environments remain largely as they currently are, KCSR will be able to meet this challenge. KCSR plans to focus on three major areas: (1) line capacity expansion, (2) terminal improvements, and (3) locomotive acquisitions. These planned improvements will benefit the entire rail network, and will contribute particularly to improving our ability to serve the coal market. For example, key to our ability to handle existing and additional coal movements is our locomotive investment program. KCSR put 33 new locomotives into service in 2006 and plans to add over 120 new locomotives in 2007. In so doing, the average age of KCSR's six axle locomotive fleet (the kind of locomotives that KCSR uses in coal service as well as in other longer-haul services) will decrease by 5%. With these new locomotives on our system, KCSR will be able to move coal faster, more reliably, and with less environmental impact.

KCSR is accelerating capital improvements on its key coal routes to better support existing traffic and to meet expected increases in coal tonnage over those routes. In 2006, over 20% of KCSR's main coal routes benefited from our tie replacement and ballast programs. By the end of 2007, this figure will rise to near 50%.

In addition to improved maintenance and locomotive acquisitions, KCSR plans to extend strategic sidings on its key coal routes to 8,700 feet so as to handle longer trains. In some areas, KCSR has already added new sidings, some double track, and power switches. As a result of KCSR's coal infrastructure improvement activities, from June

2006 to June 2007 average coal train speeds system-wide have held steady at 22.8 mph even though our coal volumes have increased 5.36% over that same period.

While our past investments and the future planned network enhancements discussed above will be adequate to maintain coal train velocities in the face of increasing volumes, such programs merely keep up with short-term, incremental growth. They do not account for the potential investment needed in the event that our energy volumes increase more than expected, especially in the coal area. While KCSR is hopeful that its share of coal traffic will continue to grow, KCSR cannot commit limited resources to the mere possibility that substantial increases will actually materialize. In KCSR's view, the electricity-generating market is changing rapidly, and the vagaries in that industry make it difficult to know if increased infrastructure investment targeted to the coal supply market would be a wise choice.

For example, while KCSR is confident that domestic consumption of goods, foreign trade policies, and ever increasing highway congestion will continue to spur tremendous intermodal market growth (for which KCSR's aggressive infrastructure programs are clearly necessary), the same perhaps cannot be said with respect to coal. Despite the obvious abundance of recoverable, domestic coal resources and plans for some new coal-burning power plants across the country, there are countercurrents that may undercut what otherwise would likely be continued growth in coal use. With the shifting winds of U.S. energy and environmental policy, it is difficult to know whether long-term increases in demand for coal transportation will actually materialize. In the face of such uncertainties, it is difficult for KCSR to invest in increased capacity for coal traffic that may not materialize.

While it is proper and right for this Board to examine the railroad industry's ability to adequately and efficiently handle the movement of coal and other commodities used in producing energy, government policies cannot, and must not, focus exclusively on the railroad component of the energy supply network. Rather, the Board must look at the entire energy supply network.

Network is the key word here. Railroads are just one part of the supply-chain. What happens with respect to the loading and unloading capabilities at both origin and destination plays another role, and the marketing, pricing, and inventory policies of the utility industry themselves plays perhaps the most important role.

Within the railroad portion of the energy supply chain, there is extensive interdependence. As noted, while KCSR handles approximately 8.5% of all coal originating in the Powder River Basin, we do not originate any of that coal ourselves. Instead, we receive that coal in interchange with either the BNSF or UP at Kansas City and then terminate at plants and facilities located on our lines. As such, KCSR is but a part of an interline network of railroads involved in the movement of coal traffic to destinations on KCSR. If either KCSR or its connections have an interruption in service capacity, deliveries will, unavoidably, be affected. For example, in the flooding that resulted in several Midwestern states from heavy rains in late June and early July this year, coal transport routes were temporarily closed on all major western carriers. These interruptions almost undoubtedly affected interline coal deliveries by eastern carriers as well.

Accordingly, while KCSR strives to ensure that service and cycle times to online utilities are adequate for their needs, there is sometimes little that one carrier can do to

overcome service problems on connecting carriers. For its part, KCSR believes that the service it provides to coal-burning utilities on its system has been, and continues to be, very good, thanks in part to the cooperation of our connections. Moreover, KCSR is continually working with our connecting carriers and others to improve the interchange at Kansas City through such efforts as building fly-overs, re-configuring yards, adding staging tracks, and increased electronic data interchange and communication.

While KCSR and the other railroads are doing their part to maximize coal train cycle times, that is only one component. KCSR does not have any control over the efficient spotting and loading of coal hoppers at the mine loadout, has very little input in the staging and unloading of cars by the utility companies once the cars are placed on utility owned tracks, does not determine the size and types of the utilities' car fleet (almost all coal hopper cars are privately owned by the utilities and third parties and are not railroad owned or controlled cars), or, most importantly, has absolutely no say in the marketing, pricing, and inventory policies of the utility industry itself. Yet, it is these components, i.e. the ones outside of KCSR's control, which drive the energy supply chain market and influence the type of infrastructure investments KCSR can sensibly make now and in the future.

Thus, for example, while railroads were heavily criticized by the utility industry for causing the coal stockpile shortages, and the Federal Energy Regulatory Commission even held a hearing on the subject, it was the utility industry's own inventory policies that likely contributed to the problem.¹ As utilities shifted to "just-in-time" inventory in order

¹ Stan Kaplan, et. al., "Coal and gas prices: planning for an uncertain fuel future," *Power Engineering*, January 2003, and Richard Bonskowski, *The U.S. Coal Industry in the*

to free up capital for other uses, the traditional two to three months of available coal inventory were reduced to one month. With inventory reduced to such low levels, when the rail industry suffered weather problems or network congestion, or there problems at the mines, there simply was not enough coal available to burn and railroads could not deliver it fast enough.

The point of this illustration is not to resurrect an old debate or to place blame, but to point out the inter-connectivity of the entire energy supply-chain network. Adding to the complexity are the implications to the transportation network that are caused by government environmental policies favoring natural gas over coal and policies associated with developing “clean coal” technologies. Add to that the policies associated with ethanol and biofuels, and it is easy to see that the solution to improving the energy supply transportation network cannot be found by focusing solely on the rail network or problems associated with any one railroad.

While KCSR appreciates the Board’s efforts to examine the very complex issues related to the efficiency and reliability of rail transportation for coal and other critical energy resources, the Board should not act precipitously to “fix” a perceived problem that may not exist or to further complicate the network by adopting policies that would curtail the KCSR’s ability to earn its cost of capital. Because there are so many variables and it takes time to adjust to fluctuations in supply and demand, the best policy is to allow the marketplace to work.

Yet, the Board can and should play a role in facilitating dialogue and encouraging communication among and amongst the various components of the network – coal mine

1990's: Low Prices and Record Production, Energy Information Administration, September 1999.

owners, railroads, utilities, and government decision makers. To this end, KCSR encourages the Board to continue with its fact finding hearings, to help facilitate continued dialogue, to find ways to encourage and support the development of more infrastructure, and to support the continued long-term financial viability of the rail industry.