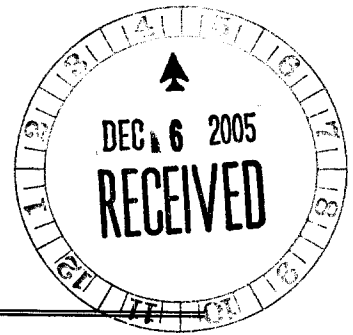


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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

WESTERN FUELS ASSOCIATION, INC.
and BASIN ELECTRIC POWER
COOPERATIVE, INC.

Complainants,

v.

BNSF RAILWAY COMPANY

Defendant.

Docket No. 42088

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Public Record

BRIEF OF COMPLAINANTS
WESTERN FUELS ASSOCIATION, INC.
AND BASIN ELECTRIC POWER COOPERATIVE, INC.

WESTERN FUELS ASSOCIATION, INC.
and BASIN ELECTRIC POWER
COOPERATIVE, INC.

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ACRONYMS

The following acronyms are used:

AEO 2005	Annual Energy Outlook, 2005 edition, published by the EIA
Basin/Basin Electric	Basin Electric Power Cooperative, Inc.
BNSF	BNSF Railway Company, f/k/a The Burlington Northern and Santa Fe Railway Company
DCF	discounted cash flow
EIA	Energy Information Administration, U.S. Department of Energy
G&A	general and administrative
ICC	Interstate Commerce Commission
LRR	Laramie River Railroad
LRS	Laramie River Station
MMP	Modified Mileage Prorate
MSP	Modified Straight Mileage Prorate
PRB	Powder River Basin of Wyoming
RAM	WFA/Basin's Reasonable Allocation Methodology
RCAF-A	rail cost adjustment factor, adjusted for changes in productivity
RCAF-U	rail cost adjustment factor, unadjusted for changes in productivity
RSAM	Revenue Shortfall Allocation Method
R/VC	revenue-to-variable cost
RTC	Rail Traffic Controller model
SAC	stand-alone cost
SARR	stand-alone railroad
STB	Surface Transportation Board
UP	Union Pacific Railroad Company
URCS	Uniform Rail Costing System
WFA/ Western Fuels	Western Fuels Association, Inc.

CASE GLOSSARY

The following short form case citations are used:¹

<u>APS I</u>	<u>Arizona Public Service Co. v. Atchison, Topeka and Santa Fe Ry.</u> , 2 S.T.B. 367 (1997)
<u>APL</u>	<u>Arkansas Power & Light Co. v. Burlington Northern R.R.</u> , 3 I.C.C.2d 757 (1987)
<u>CPL</u>	<u>Carolina Power & Light Co. v. Norfolk Southern Ry.</u> , STB Docket No. 42072 (STB served Dec. 23, 2003)
<u>Coal Rate Guidelines or Guidelines</u>	<u>Coal Rate Guidelines, Nationwide</u> , 1 I.C.C.2d 520 (1985), <u>aff'd sub nom. Consolidated Rail Corp. v. United States</u> , 812 F.2d 1444 (3 rd Cir. 1987)
<u>Duke/CSX</u>	<u>Duke Energy Corp. v. CSX Transportation, Inc.</u> , STB Docket No. 42070 (STB served Feb. 4, 2004)
<u>Duke/NS I</u>	<u>Duke Energy Corp. v. Norfolk Southern Ry.</u> , STB Docket No. 42069 (STB served Nov. 6, 2003)
<u>FMC</u>	<u>FMC Wyoming Corp. v. Union Pacific R.R.</u> , STB Docket No. 42022 (STB served May 12, 2000)
<u>McCarty Farms</u>	<u>McCarty Farms, Inc. v. Burlington Northern, Inc.</u> , 2 S.T.B. 460 (1997)
<u>Nevada Power II</u>	<u>Bituminous Coal -- Hiawatha, Utah to Moapa, Nevada</u> , 10 I.C.C.2d 259 (1994)
<u>OPPD</u>	<u>Omaha Public Power District v. Burlington Northern R.R.</u> , 3 I.C.C.2d 123 (1986), <u>aff'd on appeal</u> 3 I.C.C. 2d 853 (1987)
<u>PPL</u>	<u>PPL Montana, LLC v. Burlington Northern and Santa Fe Ry.</u> , STB Docket No. 42054 (STB served Aug. 20, 2002)
<u>TMPA I</u>	<u>Texas Municipal Power Agency v. Burlington Northern and Santa Fe Ry.</u> , STB Docket No. 42056 (STB served March 24, 2003)

¹ For brevity, the full case citations will not be repeated in the brief text.

<u>WTU</u>	<u>West Texas Utilities Co. v. Burlington Northern R.R.</u> , 1 S.T.B. 638 (1996), <u>aff'd sub nom. Burlington Northern R.R. v. STB</u> 114 F.3d 206 (D.C. Cir. 1997)
<u>WPL I</u>	<u>Wisconsin Power & Light Co. v. Union Pacific R.R.</u> , STB Docket No. 42051 (STB served Sept. 13, 2001)
<u>Xcel I</u>	<u>Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry.</u> , STB Docket No. 42057 (STB served June 8, 2004)
<u>Xcel II</u>	<u>Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry.</u> , STB Docket No. 42057 (STB served Jan. 19, 2005)

CASE OVERVIEW

This is a maximum coal rate case. Complainants Western Fuels Association, Inc. ("Western Fuels") and Basin Electric Power Cooperative, Inc. ("Basin Electric") (collectively "WFA/Basin") respectfully request that the Surface Transportation Board ("STB" or "Board") prescribe a maximum rate on the issue traffic equal to \$3.37 per ton, effective as of October 1, 2004. This rate approximates 20 mills per revenue ton-mile. WFA/Basin also respectfully request the Board to order the Defendant, BNSF Railway Company ("BNSF"), to pay WFA/Basin reparations (with interest) for overcharges WFA/Basin have incurred and to prescribe specified rates to apply to the issue traffic for future time periods.

A. Background Facts¹

Basin Electric is a non-profit rural electric cooperative. Basin Electric operates the Laramie River Station ("LRS") situated near Wheatland, WY. LRS is a coal-fired plant jointly owned by Basin Electric and five other non-profit power providers. Western Fuels is a non-profit fuel supply cooperative that purchases coal transportation for the LRS owners. LRS burns over 8 million tons of Powder River Basin ("PRB") coal annually. Electricity generated by LRS is ultimately purchased and consumed, for the most part, by small ranchers, farmers, households and businesses located in the rural west, midwest and southwest.

BNSF is a common carrier by rail. BNSF is the only rail carrier serving LRS. BNSF transports WFA/Basin's PRB coal purchases from the PRB to LRS – an average distance of approximately 171 miles. This transportation is in unit trains that typically consist of 136 rail cars (most of which WFA/Basin supply). Between 1984 and September 2004, BNSF provided PRB-to-LRS service under a contract. This contract was a highly lucrative one for BNSF.

¹ See generally WFA/Basin Opening Narrative ("Op. Narr.") at IV-A-1 to 8.

BNSF's average rate-to-cost ("R/VC") ratios on the LRS contract traffic exceeded 200% and BNSF earned profits of over \$311 million during the 20-year contract term.

Prior to the expiration of its contract, WFA/Basin attempted to negotiate a new contract with BNSF containing reasonable pricing terms. BNSF had other plans. On September 20, 2004, BNSF published tariff terms to apply to the LRS traffic, starting on October 1, 2004. BNSF's initial tariff rates were over twice as high as WFA/Basin's expiring contract rates. BNSF's tariff also contains convoluted tariff rate adjustment procedures that subject the initial tariff rates to huge additional increases over time.² BNSF's tariff pricing actions are punitive under any measure:³

- BNSF's rate increases initially more than doubled the expiring LRS contract rates and the more-than-doubled rates will more-than-double again over the 20-year discounted cash flow ("DCF") period. No coal shipper has ever been faced with percentage increases of this magnitude.

- BNSF's massive rate increases translate into massive profit increases for the high-volume LRS traffic. In the last year of the LRS contract, WFA/Basin paid approximately { } to BNSF. In 2005, WFA/Basin will pay BNSF approximately { }, a profit increase of { }. By the end of 2007, the annual increase in profit is projected at over { }. During the 20-year DCF period, the total profit increase is over \$1 billion. No western coal shipper has ever been faced with payment increases of this magnitude.

- BNSF's system-average R/VC ratio in 2004 equaled 131%. The system-average R/VC

² See WFA/Basin Op. Narr. at IV-A-5 to 7.

³ See WFA/Basin Rebuttal Narrative ("Reb. Narr.") at III-H-6 to 8.

ratio BNSF needed to be considered revenue adequate in 2004 equaled 144%. BNSF's initial 4Q04 tariff rates produced average R/VC ratios of 478%. These averages will increase to 649% in 2007 and, by the end of the DCF period, will exceed 847%.

- BNSF's system-average rates for coal per revenue ton-mile equaled 9.6 mills in 2004. BNSF's initial 4Q04 tariff rates (with surcharges) equaled 38.2 mills. These tariff rates will increase to 44.5 mills in 2007 and, by the end of the DCF period, will exceed 88.0 mills.

BNSF's outrageous pricing actions left WFA/Basin with no alternative but to file the instant case. BNSF's pricing actions have also generated a firestorm of public outrage throughout the west. Statements of grave concern over BNSF's actions have been submitted by the over 200 cooperative, municipal and public power systems the LRS owners serve; the American Public Power Association; the National Rural Electric Cooperative Association; thirteen United States Senators; nine members of the United States House of Representatives; three state Governors; and two state Attorneys General. See WFA/Basin Op. Narr. Part IV-B. These statements are included in Exhibits IV-B-1 through IV-B-10 of WFA/Basin's Opening Evidence.

B. Core Case Issues

The STB has jurisdiction to set maximum rates if the defendant carrier possesses market dominance over the issue traffic. 49 U.S.C. §10707(c). BNSF concedes that it exerts qualitative market dominance (i.e., WFA/Basin have no effective transportation alternatives for BNSF's PRB-to-LRS service) and quantitative market dominance (i.e., BNSF's tariff rates exceed 180% of the variable costs BNSF incurs in providing PRB-to-LRS service). See BNSF

Reply Narrative ("Reply Narr.") at II-33 to 34.⁴

In 1985, the STB's predecessor, the Interstate Commerce Commission ("ICC" or "Commission") promulgated the Coal Rate Guidelines. These Guidelines establish the standards the ICC used, and the Board continues to use, to set maximum rates on market dominant rail traffic. WFA/Basin have invoked the Stand-Alone Cost ("SAC") constraint set forth in the Guidelines. The SAC constraint authorizes a complainant shipper to model a hypothetical Stand-Alone Railroad ("SARR") that provides service for the complainant shipper and others along the SARR route of movement. A complainant shipper is entitled to rate relief if, over a stated period (usually 20 years), SARR revenues exceed SARR costs (on a present value basis). Id. at 545.

The ICC acknowledged in the Coal Rate Guidelines that the viability of a SARR is density driven – i.e., a SARR must achieve sufficient traffic densities for SARR revenues to exceed SARR costs. Id. at 543. The SAC test should work well for the LRS traffic because of the available traffic densities. The Laramie River Railroad ("LRR") traverses for most of its route one of the densest portions of the BNSF system – the PRB region. See WFA/Basin Reb. Narr. at III-A-49.

WFA/Basin's evidence demonstrates that LRR revenues substantially exceed LRR stand-alone costs, and the resulting initial maximum rate for the LRS traffic approximates 20 mills per revenue ton-mile. The result is one the Coal Rate Guidelines contemplated (given the LRR's

⁴ BNSF concedes the R/VC ratios on the LRS traffic exceed 300% of its variable costs of service. However, BNSF substantially overstates its variable costs. See WFA/Basin Reply Narr. at II-A-1 to 18; WFA/Basin Reb. Narr. at II-A-1 to 42. The correctly calculated R/VC ratios exceed 450%. See WFA/Basin Reb. Narr. at II-A-42.

traffic densities) and is consistent with the results reached by the Board in prior PRB coal rate cases.⁵

BNSF asks the Board to reach a different result. BNSF argues that LRR costs substantially exceed LRR stand-alone revenues. Accordingly, BNSF claims WFA/Basin are entitled to no rate relief. BNSF's SAC calculations differ greatly from both WFA/Basin's calculations, and the Board's SAC calculations in recent PRB coal rate cases, because BNSF refuses to adhere to the Coal Rate Guidelines' standards. BNSF's positions are not surprising. As Board counsel recently observed in another case, BNSF "objects to any restraint on its pricing" and "any application of the SAC test that results in relief to captive shippers."⁶ This case is no different except for the utter outrageousness of BNSF's tariff rate actions and its SAC calculations.

ARGUMENT

WFA/Basin look to the Board as the last line of defense against BNSF's monopoly pricing abuses. Left unchecked, BNSF's rate actions will subject LRS-served customers to \$1 billion in rate increases. The Coal Rate Guidelines were promulgated to protect captive coal consumers from this type of monopoly pricing abuse.

WFA/Basin's evidence demonstrates, inter alia, that BNSF's pricing actions violate the Guidelines' SAC constraint. WFA/Basin present a SAC case that fully complies with

⁵ See WPL I (prescribing 9.8 mill maximum rates); TMPA I (prescribing 13.1 mill maximum rates for movements in BNSF-supplied cars); Xcel I (prescribing 20.2 mill maximum rates).

⁶ Brief for Respondent STB, BNSF Ry. v. STB, No. 05-1030, (D.C. Cir. filed July 21, 2005) at 36 ("Board's Xcel Brief").

governing Board precedent. WFA/Basin also solve Board-acknowledged faults in its current administration of the SAC constraint, including problems with the Board's percentage reduction methodology and problems in indexing SARR operating costs. WFA/Basin's solutions are consistent with the Guidelines and sound public policy.

BNSF, on the other hand, tries to undermine Board precedent at every turn. BNSF challenges WFA/Basin's clear right under the Guidelines to build traffic densities, vastly understates the LRR's revenues, and vastly overstates the LRR's costs. BNSF also attempts to set the LRR tariff rates (as adjusted) at levels that are so high that any percentage reduction answer will not produce any meaningful relief for WFA/Basin.

WFA/Basin appear here on behalf of the rural customers served by LRS. These customers -- many of whom are of modest means -- are the ultimate payors of BNSF's rates. They are entitled to substantial rate relief. All relief ordered by the Board will flow through directly to these consumers. See WFA/Basin Op. Narr. IV-A-3; WFA/Basin Op. Exhibit IV-B-8.

I.
THE COMPOSITION OF THE LRR
COMPLIES WITH THE
COAL RATE GUIDELINES

BNSF's repeatedly claims that WFA/Basin are "gaming" the Coal Rate Guidelines by modeling a high density SARR. These contentions are ludicrous. WFA/Basin are not "gaming" the Guidelines because the Guidelines expressly encourage shippers to maximize SARR traffic densities. All of BNSF's bombastic rhetoric cannot obscure the simple fact that WFA/Basin fully complied with the Guidelines in modeling the LRR. Indeed, WFA/Basin's approach is a very conservative one.

**A. The Guidelines Encourage Shippers
to Model High-Density SARRs**

The Coal Rate Guidelines require a shipper to configure a SARR so that the SARR serves the origin(s) and destination(s) of the issue traffic.⁷ The LRR complies with that requirement: the LRR serves the LRS traffic origins and destination. The Guidelines also permit and encourage shippers to augment the issue traffic volumes with other traffic. This augmentation, called “grouping,” is necessary to build the traffic volumes necessary for the SAC standard to work. See Guidelines at 544 (“The ability to group traffic of different shippers is essential.... It allows the captive shipper to identify areas where production economies define an efficient subsystem....”)

The Guidelines accord a shipper “broad flexibility” to model a “least costly” SARR that “tak[es] advantage of economies of density.” Id. at 543. The ICC and the Board have repeatedly reaffirmed that captive shippers have broad discretion in configuring a SARR to maximize traffic density.⁸ See WFA/Basin Reb. Narr. at III-A-1 to 4.

**B. WFA/Basin have Conservatively
Designed the High-Density LRR**

WFA/Basin have exercised their broad grouping rights in a very conservative manner in this case. The LRR simply replicates service to BNSF’s current PRB utility coal customer base and routes that traffic in the same manner BNSF does today. This is as simple, and conservative, as one can get in designing a SARR. Significantly, WFA/Basin did not use modeling techniques that have been controversial in prior cases. For example, the LRR contains

⁷ See Metropolitan Edison Co. v. Conrail, 5 I.C.C. 385, 420 (1989). The destination refers to the destination of the issue traffic on the defendant carrier’s line.

⁸ See, e.g., WTU, 1 S.T.B. at 655; WPL I at 12 n. 20; APL, 3 I.C.C. 2d at 773.

no re-routed traffic (i.e., current BNSF traffic that is re-routed to utilize the LRR facilities) and no traffic BNSF does not currently transport (e.g., PRB coal traffic Union Pacific Railroad Company (“UP”) currently originates). See WFA/Basin Reb. Narr. at III-A-4.

The LRR, as conservatively configured by WFA/Basin, provides unit-train coal service for the issue LRS traffic. The LRR also originates unit train coal traffic for 36 other utility customers. The LRR’s non-issue traffic movements are classified as “cross-over” traffic movements. On these cross-over movements, the LRR transports the coal from PRB origin mines to various interchange points with the residual BNSF. The residual BNSF then transports the coal from the interchange points either to utility coal-fired plants or to interchange points with other carriers for movement beyond to utility coal-fired plants. All told, LRS-originated traffic moves to 76 power plant destinations. See WFA/Basin Op. Narr. at III-A-4.

C. WFA/Basin Properly Included Cross-Over Traffic and Short-Haul Traffic in the LRR

BNSF’s filings contain lengthy diatribes accusing WFA/Basin of “gaming” the SAC process by including cross-over traffic in the LRR and by including what BNSF terms “short-haul” traffic in the LRR’s traffic group. See e.g., BNSF Reply Narrative (“Reply Narr.”) at III.A-15, III.A-5. In fact, inclusion of cross-over and short-haul traffic is permitted and encouraged by the Guidelines.

- Cross-Over Traffic. The Board has repeatedly held that the Guidelines permit shippers to utilize cross-over traffic to create SARR traffic densities. See Xcel I at 13 (and cases cited). BNSF repeats here the same tired arguments that SARR’s should not be permitted to carry cross-over traffic. The Board has rejected these arguments in prior cases and should do so here as well. Use of cross-over traffic is a perfectly permissible way to build SARR

traffic densities. See WFA/Basin Reb. Narr. at III-A-5.

- Short-Haul Traffic. BNSF also lathers its filings with repeated references to the alleged evil of “short-haul” traffic. BNSF’s rantings find no support in the Guidelines. The Guidelines provide shippers with “broad flexibility” to design SARRs to include traffic of any length (short, long or in-between). Id. at 543. Moreover, the LRR contains “short haul” traffic because the LRR is a short haul carrier – a result produced by geography, not gaming. The LRR follows the LRS route of movement – which averages 171.2 miles – about 19% of the BNSF system average haul (922.1 miles). See WFA/Basin Reb. Narr. at III-A-9.⁹

II. WFA/BASIN CORRECTLY CALCULATE LRR TRAFFIC VOLUMES

WFA/Basin calculate that the LRR coal traffic volumes will equal 205.3 million tons in 2005. These volumes will gradually increase to 219.4 million tons in 2023. Overall, WFA/Basin project the LRR will carry 4.3 billion tons of coal over the 20-year DCF period. See id. at III-A-12.

WFA/Basin’s volume calculations follow procedures the Board has applied in Xcel and other recent cases. These procedures establish a step-by-step method to forecast SARR volumes over the 20-year DCF period. BNSF asks the Board to significantly reduce LRR traffic volumes, principally by excluding what BNSF calls “cross-subsidy” traffic and by using an internal BNSF forecast to project LRR volumes in the 2006 to 2009 time period. Both BNSF

⁹ Similarly, the average haul length for LRR cross-over traffic is 71.1 miles. This mileage is short compared to BNSF’s system average coal route miles but, again, this is a result produced by geography, not gaming. Nor are these mileages inconsistent with governing precedent. For example, in TMPA, the average length of cross-over moves constituted 31% of the total SARR route miles. In comparison, the average length of LRR cross-over moves constitutes 32.6% of the LRR’s total route miles. See WFA/Basin Reb. Narr. at III-A-10.

proposals mistakenly deviate from governing precedent.

- Cross-Subsidy. BNSF argues that LRR tonnages originating north of Donkey Creek, WY should be excluded from the LRR traffic group because, BNSF alleges, the LRR revenues for this traffic exceed the SAC costs for this segment of the LRR. BNSF presented the very same cross-subsidy theory in PPL and the Board correctly rejected it. The Board ruled in PPL that a SARR cross-subsidy exists when stand-alone revenues for traffic moving on a SARR segment are less than “the collective attributable costs associated with serving [this] traffic.” Id. at 9-10. BNSF has made no attempt to meet the PPL test in this case. Conversely, WFA/Basin have shown there is no cross-subsidy because all LRR traffic segments generate revenues that exceed attributable costs. See WFA/Basin Reb. Narr. at III-A-67.

- 2006-2009 Traffic Projections. BNSF argues that the Board should adjust LRR traffic volumes during the 2006-2009 period using a BNSF system-wide coal forecast. The Board rejected a similar BNSF claim in Xcel, holding that the proper procedure is to project SARR tonnages using the Energy Information Administration’s (“EIA’s”) Annual Energy Outlook (“AEO”) PRB coal forecasts. See Xcel I at 53; Xcel II at 14-15. WFA/Basin properly followed Xcel by projecting LRR traffic growth in the 2006 to 2009 time period using EIA’s most recent PRB forecasts as set forth in the 2005 AEO (“AEO 2005”). See WFA/Basin Reb. Narr. at III-A-13 to 15.

III. WFA/BASIN CORRECTLY CALCULATE LRR SAC REVENUES

WFA/Basin calculate that the LRR revenues will equal \$329.3 million in 2005. These revenues increase over time to \$512.8 million in 2023. Overall, WFA/Basin project LRR revenues of \$8.3 billion over the 20-year DCF period. See id. at III-A-70.

WFA/Basin's revenue calculations follow procedures the Board applied in Xcel and other recent cases. These procedures provide a step-by-step process to forecast line-haul revenues for the SARR, and the residual incumbent, over the 20-year DCF period and to allocate the forecasted revenues between the SARR and the residual incumbent. BNSF proposes radical, ill-advised departures from these procedures in a desperate attempt to drastically reduce the LRR's revenues on cross-over traffic.

A. The Board Should Continue to Apply MSP Divisions

WFA/Basin calculate LRR/residual BNSF divisions using the Board's Modified Straight Mileage Prorate ("MSP") methodology. "Under the MSP approach, revenue from cross-over traffic is allocated based on the total mileage hauled by the SARR and the residual carrier, while retaining a 100-mile additive for originating or terminating the traffic." Xcel I at 17. The Board has consistently applied the MSP method, or its predecessor, the Modified Mileage Prorate ("MMP") methodology,¹⁰ in its last nine SAC cases involving cross-over traffic.¹¹ These decisions include calculations of cross-over divisions on many of the same PRB traffic routings that WFA/Basin have included in the LRR.¹²

Under MSP, the LRR divisions in 2005 equal on average { }¹³

WFA/Basin present substantial evidence demonstrating these results conform to "the underlying

¹⁰ MSP is a "refinement" of MMP. Xcel II at 8. "The only difference between the two approaches is that the lumps in the [MMP] Methodology have been smoothed out." Duke/NS I at 24.

¹¹ See McCarty Farms at 472; FMC at 31; WPL I at 24; PPL at 11; TPPA I at 31; Duke/NS I at 25; CP&L at 21; Duke/CSX at 22; Xcel I at 17-19; and Xcel II at 11.

¹² See Xcel I at 19, 44 (STB applies MSP to calculate divisions for SARR-originated PRB traffic, including the LRR movement); TPPA at 31, 66 (STB applies MMP to calculate SARR divisions for SARR-originated PRB traffic, including traffic interchanged with the residual BNSF at Donkey Creek, Bridger Jct., and Moba Jct.).

¹³ See electronic workpaper file "LRR Traffic and Revenues_WFABasin Rebuttal.xls" sheet "SARR Traffic_2005."

realities of real-world railroading.” See Xcel II at 12 (the assumptions used in the SAC analysis “must be ... consistent with the underlying realities of real-world railroading”). This evidence shows that the LRR divisions are consistent with the divisions earned by a real-world comparable railroad to the LRR – Western Railroad Properties, Inc.; are consistent with the divisions BNSF, and its connections, earn on comparable real-world traffic; and are consistent with other relevant market and cost factors.¹⁴

BNSF claims MSP should not be used in this case. The burden is on BNSF to demonstrate that it has a “superior” approach. See Board’s Xcel Brief at 52 (“the burden was on BNSF to make a convincing showing that its alternative [divisions] approach was superior to [MSP]”); PPL (STB decision served Nov. 27, 2001) at 6 n.18 (same). BNSF fails to do so.

- Avoidable Cost Divisions. BNSF first proposes to set divisions on the LRR segment at BNSF’s “avoidable costs” for providing LRR service. These divisions approximate, on average { } in 2005.¹⁵ BNSF calculates these “avoidable costs” as equaling BNSF’s Uniform Rail Costing System (“URCS”) variable costs of providing LRR service.

BNSF’s avoidable cost division theory is a non-starter. BNSF’s avoidable cost theory is predicated upon the principle that SARR divisions should be set based upon a simulated competition between the defendant carrier and the SARR for the SARR traffic. The ICC, and the

¹⁴ See WFA/Basin Op. Exhibits III-A-3 and III-A-4; WFA/Basin Reb. Narr. at III-A-48 to 54. The ICC and the Board have relied on MMP, and MSP, as surrogates for market-based SARR divisions (which include cost considerations). See e.g., Nevada Power II at 280. To the extent the Board’s decision in Duke/NS departed from a market-based SARR division test, it was wrongly decided. See WFA/Basin Reb. Narr. at III-A-50 to 65.

¹⁵ See BNSF Errata electronic workpaper file “LRR Traffic and Revenues _ WFA Basin Opening_BNSF Revised.xls.” sheet “SARR Traffic _ 2005.”

Board, have consistently rejected this theory in every case where it has been presented on grounds that a SARR is correctly viewed as a replacement for, not as a competitor of, the defendant carrier. See WFA/Basin Reb. Narr. at III-A-32 to 40.

BNSF's witness Kalt claims that the ICC and the Board have misapplied the "contestability" theory over the past 20-years by treating the SARR as a replacement carrier. However, as WFA/Basin witnesses Borts and Grimm – two of the nation's leading SAC theorists – attest, the ICC's and the Board's prior decisions correctly apply contestability theory. Contestability theory is predicated upon potential entrants evaluating "the profitability of entry at the incumbent firm's pre-entry prices" without "fear of retaliatory price alterations" by the incumbent.¹⁶ Also, BNSF's avoidable cost division method impermissibly violates longstanding Board precedent rejecting division methods that set SARR divisions "down close to [the defendant's] variable cost levels." Duke/NS I at 18; see also Nevada Power II at 266.

- Modified MSP. BNSF poses a second alternative to set SARR divisions – a "modified" MSP. Under BNSF's "modified" MSP approach, the 100-mile MSP origin and destination blocks are reduced to 25 miles (for trains with shipper-supplied cars) and 57 miles (for trains with carrier-supplied cars). See WFA/Basin Reb. Narr. at III-A-41. BNSF's modified MSP is also a non-stater. BNSF's modified MSP produces SARR divisions that are less than BNSF's avoidable cost divisions – i.e. less than BNSF's calculated URCS variable costs of providing LRR service. Id. at III-A-42 to 43. These results are impermissibly low. See Duke/NS at 18; Nevada

¹⁶ See WFA/Basin Reb. Narr. at III-A-34 (quoting Baumol, Danzar and Willig, Contestable Markets and the Theory of Industry Structure at 349, 5 (Rev. ed. 1988) ("Contestable Markets")); accord Bailey & Baumol, Deregulation and the Theory of Contestable Markets, 1 Yale J. on Reg. 111, 114 (1984) ("[a] contestable market works most effectively if, in response to a profit-making opportunity, new firms can enter quickly, earn profits at least temporarily (before incumbents can constitute countermeasures) and then leave without any loss of investment or sunk capital").

Power II at 226. BNSF's modified MSP approach is also subject to numerous other methodological flaws, including the following: BNSF mistakenly equates the 100-mile MSP origin block as a block of "system average" costs, BNSF fails to make any "relative cost" calculations, and BNSF's approach ignores market realities. See WFA/Basin Reb. Narr. at III-A-43 to 50.

**B. The Board Should Accept WFA/Basin's Evidence
on Disputed Cross-Over Traffic Revenue Forecast Issues**

WFA/Basin's evidence is superior to BNSF's on other consequential revenue forecast issues.

- WFA/Basin's Cross-Over Traffic Revenue Forecasts. As called for under the Xcel procedures, WFA/Basin's LRR revenue forecasts start with BNSF's market (or prescribed) rates for the involved LRR traffic. WFA/Basin then project these revenues over the DCF period using a combination of plant-specific, and AEO 2005 PRB-specific, revenue forecasts.
- BNSF Cross-Over Traffic Revenue Forecasts. BNSF uses two different revenue forecast procedures. Under its modified MSP approach, BNSF departs from the Xcel procedures by proposing to utilize an internal BNSF system-wide revenue forecast, not the AEO 2005 PRB forecast, to project LRR line-haul revenues between 2006 and 2009. The Board properly rejected a similar proposal in Xcel. See WFA/Basin Reb. Narr. at III-A-25 to 27. BNSF's modified MSP forecast also mistakenly fails to utilize the AEO 2005 diesel fuel forecast to forecast BNSF's fuel surcharge revenues. Id. at III-A-27 to 29. BNSF's avoidable cost division forecast is even worse. BNSF proposes to adjust LRR divisions using the rail cost adjustment factor, adjusted for changes in productivity ("RCAF-A") – an approach that

mistakenly ignores all of the governing Xcel procedures – in order to minimize the LRR’s revenue growth over time. Id. at III-A-29.

- LRS Rate Forecasts. WFA/Basin adjust the initial LRS tariff rates for DCF purposes using Global Insight’s RCAF-U forecast. BNSF purports to apply the LRR tariff rate adjustment procedures. WFA/Basin’s approach is correct for the reasons summarized in section VI below.

IV. WFA/BASIN CORRECTLY CALCULATE LRR SAC COSTS

WFA/Basin calculate the LRR’s base-year operating costs as equaling \$109 million. WFA/Basin calculate the LRR’s construction costs as equaling \$792 million. BNSF calculates substantially higher costs: BNSF’s base-year LRR operating costs equal \$181 million and BNSF’s proposed LRR construction costs equal \$1,379 million. See WFA/Basin Reb. Narr. at III-D-1 and III-F-1.

WFA/Basin’s operating cost calculations, and their construction cost calculations, are in line with those the Board approved in its most recent PRB coal rate decisions. BNSF’s are not. For example, the Xcel SARR, like the LRR, was a coal-only PRB SARR. The LRR replicates the northern portion of the Xcel SARR. In Xcel, the Board set operating expenses at \$220,000 per track-mile and construction costs at \$1.86 million per track-mile. WFA/Basin’s LRR calculations set comparable operating expenses (\$248,000 per track-mile) and construction costs (\$1.83 million per track-mile). BNSF, however, calculates vastly higher operating costs (\$365,000 per track-mile) and vastly higher construction costs (\$2.98 million per track-mile). See WFA/Basin Reb. Narr. at III-D-3 and III-F-13.

The Board should accept WFA/Basin's LRR operating and construction costs, not BNSF's vastly inflated costs.

**A. The LRR's Operating and
Construction Plans are Feasible**

In several recent decisions, the Board has rejected shipper-sponsored operating plans and some elements of shipper-sponsored construction plans, and accepted railroad-sponsored plans. In taking these actions, the Board has observed "[i]n SAC cases, the [defendant] railroad has the advantage of having much greater knowledge and experience in how to construct and operate a railroad." Xcel II at 5. The "advantage" the Board cited in Xcel II has no application in this case. WFA/Basin's stand-alone railroad is designed and engineered by experts (led by Paul Reistrup) that have 376 years of combined experience in the railroad industry. See WFA/Basin Op. Narr. at I-12.

WFA/Basin's expert team has designed a feasible least-cost SARR – the LRR. The LRR's least-cost network and operating plans are conservatively configured and avoid use of modeling devices (e.g., the string program) the Board has not accepted in prior cases. Here, WFA/Basin utilize the Board-approved Rail Traffic Controller ("RTC") simulation model to demonstrate the feasibility of the LRR's "peak week" network configuration and operating plan. Also, unlike other recent cases where defendant carriers have vociferously objected to the shipper's operating plan, BNSF accepts most of WFA/Basin's plan. And, where disagreements exist, WFA/Basin's evidence is demonstrably superior. See WFA/Basin Reb. Narr. at Parts III-B and III-C.

**B. WFA/Basin Correctly Calculate
 LRR Operating and Construction Costs**

WFA/Basin and BNSF develop substantially different LRR operating and construction costs principally because WFA/Basin's cost calculations conform to the Board's findings in prior PRB SAC cases whereas BNSF's do not. Indeed, for virtually all of the thousands of component parts that comprise the LRR's operating and construction costs, BNSF endeavors to inflate either the service units or the unit costs.

Page limitations preclude WFA/Basin from addressing here the vast majority of BNSF's cost inflating tactics. A few illustrative examples are set forth below:

- BNSF includes \$295 million for unneeded LRR right-of-way "retaining walls." (WFA/Basin Reb. Narr. at III-F-82 to 86).
- BNSF claims the LRR must be built to handle BNSF/UP joint-line traffic requirements – even though the LRR densities are less than one-half the joint-line densities. (*Id.* at III-F-2 to 5).
- BNSF proposes total base year LRR general and administrative ("G&A") expenses of \$26.9 million. This is more than two-and-a-half times the \$10.4 million G&A costs the Board accepted in *Xcel I*, even though the traffic groups in both cases are similar. (*Id.* at III-D-45 to 105).
- BNSF proposes total base year train and engine personnel expenses of \$29.6 million. This is more than 35% greater than the \$21.9 million the train and engine personnel expense the Board accepted in *Xcel I*, even though the LRR is 45% shorter than the *Xcel SARR*. (*Id.* at III-D-1, 46; *Xcel I* at 58).

**C. The Board Should Adjust LRR Operating
 Expenses Using the 0.59 RCAF-U**

In several recent cases the STB has been faced with a choice between indexing SARR operating costs using a forecasted RCAF-U (which has no productivity adjustment) and a

forecasted RCAF-A (which contains an industry-average productivity adjustment). In these cases, the Board chosen the forecasted RCAF-U because the Board believed the forecasted RCAF-A will overstate SARR productivity more than the forecasted RCAF-U will understate it. See WFA/Basin Op. Narr. at III-G-4 to 5.

In the instant case, the Board is given a different choice: indexing operating costs using the “BNSF Index” (BNSF’s choice) or indexing operating costs by 59% of the forecasted change in the RCAF-U (“0.59 RCAF-U”)(WFA/Basin’s choice). The Board should choose the 0.59 RCAF-U. The 0.59 RCAF-U contains a modest productivity factor (far less than the projected productivity factor in the RCAF-A), whereas the BNSF Index assumes the LRR will achieve no productivity gains through 2014 and only marginal productivity gains thereafter. See WFA/Basin Reb. Narr. at III-G-8. BNSF’s assumption that the LRR will enjoy no productivity gains through 2014, and extremely little productivity gains thereafter, is wrong. WFA/Basin’s 0.59 RCAF-U index – an index endorsed by Dr. Douglas W. Caves, one of the nation’s leading experts in rail productivity – is far superior because it is based on a realistic forecast of the LRR’s productivity-adjusted operating cost increases.¹⁷

V.
WFA/BASIN PROPERLY
CALCULATE MAXIMUM LRR RATES

WFA/Basin’s evidence demonstrates that LRR revenues exceed LRR costs by \$1,524 million over the 20-year DCF period (on a present value basis). See WFA/Basin Reb. Narr. at III-H-3. Accordingly, LRR revenues must be reduced to equal LRR costs. And, the reduction process needs to calculate movement specific SAC rates. The Guidelines do not set forth a specific method for determining movement-specific SAC rates. Xcel I at 36. Instead, the

¹⁷ See WFA/Basin Reb. Narr. at III-G-7 to 34.

Guidelines “leave this inquiry to a case-by-case analysis.” Id.

The STB currently uses the “percentage reduction” methodology to set movement-specific SARR rates. Under the percentage reduction methodology, the challenged tariff rates (and the other SARR traffic group member rates) are reduced by a uniform percentage in each DCF year so that SAC revenues, as reduced, equal SAC costs.

The percentage reduction method has a gaping flaw. Whatever rate the carrier sets (high, low, or in-between) dictates the resulting maximum rate. As a result, the percentage reduction method impermissibly shifts the power to set maximum rail rates from the Board to market dominant rail carriers. See WFA/Basin Op. Narr. at III-H-10 to 12. BNSF is exploiting this flaw by imposing, in each successive case, sequentially higher tariff rates, culminating in the tariff rates at issue in this case. See id. at III-H-13.

The STB has acknowledged the problems with its percentage reduction methodology. See CPL at 32 (“the maximum reasonable rate ... should be determined by the Board, not by the parties’ litigation tactics”). And, the Board has asked complainant shippers to propose alternatives that “remove the flaws” in the percentage reduction methodology in a manner that comports with the Coal Rate Guidelines. See CPL at 32; Xcel I at 38. WFA/Basin present two such alternatives here.

**A. The Board Should Set Maximum
LRR Rates Using RAM**

WFA/Basin’s Reasonable Allocation Methodology (“RAM”) sets LRR movement-specific maximum rates. Under RAM, each LRR shipper pays its variable costs. Captive LRR shippers pay an additional sum equal to a pro-rata share of the non-attributable LRR costs (i.e., the difference between the total LRR SAC costs and the LRR system variable

traffic costs). RAM also contains a default rule – no shipper is required to pay more than its current rate. See WFA/Basin Op. Narr. at III-H-13 to 15.

WFA/Basin's RAM methodology "remove[s] the flaws" in percentage reduction, because, unlike percentage reduction, it does not use a defendant carrier's initial tariff rates as the starting point for determining maximum rate relief. RAM removes the regulatory incentives that now exist for defendant carriers to charge astronomically high rates on market dominant coal traffic moving over high density lines.

RAM also fully comports with the Coal Rate Guidelines. The Guidelines envisioned a maximum rate procedure where non-attributable SARR costs would be shared on a pro-rata basis by SARR shippers possessing "similar demand elasticity." Id. at 527.¹⁸ The ICC proceeded to apply these principles in the first two major post-Guidelines SAC cases. See OPPD; APL. In these decisions, the ICC applied a methodology to set SARR-specific rates where all SARR shippers paid their variable costs, and captive SARR shippers (all of whom were PRB coal shippers with similar demand elasticities) paid a pro-rata share of the SARR's unattributable costs.¹⁹ RAM fully complies with the Guidelines because it follows the approach set by the Guidelines' authors in their initial post-Guidelines decisions. Under RAM, all LRR shippers pay their variable costs (subject to the default rule). RAM also allocates all unattributable LRR costs to LRR captive customers – all of whom are captive PRB coal customers with similar demand elasticities.²⁰

¹⁸ See WFA/Basin Op. Narr. at III-H-17 to 19; WFA/Basin Reb. Narr. at III-H-16 to 19.

¹⁹ See OPPD at 139-40; APL at 774; WFA/Basin Op. Narr. at III-H-19 to 21; WFA/Basin Reb. Narr. at III-H-19 to 21.

²⁰ See WFA/Basin Op. Narr. at III-H-22 to 28; WFA/Basin Reb. Narr. at III-28 to 33.

Finally, RAM addresses, and solves, BNSF's misguided concerns about some revenue divisions, i.e., those divisions that substantially exceed service costs. Under percentage reduction, the magnitude of these differentials is crucial because high differentials mathematically translate into lower movement-specific SARR rates. However, that is not true under RAM. For example, assume that on a captive cross-over movement SARR revenues equal \$10.00 per ton, SARR variable costs equal \$3.00 per ton, and the pro-rata share of unattributable SARR costs equals \$2.00 per ton. Under RAM, the cross-over shipper's movement-specific SAC rate equals \$5.00 per ton (\$3.00 variable cost + \$2.00 unattributable cost). The remaining differential \$5.00 per ton (\$10.00 - \$5.00) has no impact on the calculation of the complaining shipper's maximum rate.²¹

**B. The Reduced-Mark Up Method is
also Preferable to Percentage Reduction**

WFA/Basin present a second alternative to set LRR movement-specific maximum rates – the Reduced Mark-Up method. Under the Reduced Mark-Up method, the profit contribution made by each LRR shipper is calculated. The profit contribution equals the difference between the revenues paid by each LRR shipper and the variable costs the LRR incurs to provide that shipper with service. The contribution is then reduced on a pro-rata basis so that the LRR's revenues equal the LRR's costs.²²

²¹ See WFA/Basin Reb. Narr at III-H-15. BNSF criticizes RAM on grounds that RAM has been rejected in prior cases. However, that is wrong. RAM is predicated on procedures the ICC applied in OPPD and APL. Neither the ICC, nor the Board, rejected these procedures in subsequent cases for a simple reason – the procedures were not presented in those cases. See id. at III-H-22 to 27.

²² See WFA/Basin Op. Narr. at III-H-34; WFA/Basin Reb. Narr. at III-H-14.

Unlike RAM, the Reduced Mark-Up method does not fully solve the “starting rate” problem since under the Reduced Mark-Up method, like percentage reduction, the starting rate influences the SAC answer. However, the Reduced Mark-Up method minimizes the impact of the starting rate since the method accords the most relief to the shippers making the highest profit contributions to the LRR – e.g. WFA/Basin.²³

VI.
BNSF’S TARIFF RATE
ADJUSTMENT PROCEDURES ARE UNLAWFUL

BNSF’s tariff contains base rates that apply in 4Q04 and 2005. These rates are adjusted using a convoluted mix of fixed rate increases, fuel surcharges and, starting in 2008, the RCAF-U (minus its fuel component).²⁴ In their complaint, WFA/Basin separately challenge the legality of these rate adjustment procedures.²⁵ Governing precedent clearly allows a shipper to separately challenge the reasonableness of a carrier’s rate adjustment procedures.²⁶

²³ BNSF’s principal criticism of the Reduced Mark-Up method is that it is “inconsistent” with RAM. However, that is not the case. RAM takes a broad, long-term view of rail captivity and groups the LRR’s captive coal shippers together because they clearly possess similar transportation demand elasticities. The Reduced Mark-Up method, on the other hand, takes a snapshot approach, focusing on current R/VC relationships. These relationships, of course, can change dramatically over time without any change in the shipper’s underlying transportation demand elasticity as is evidenced by the dramatic change in the R/VC ratios on the LRS traffic in 2004 after the LRS contract expired. See WFA/Basin Reb. Narr. at III-H-35.

²⁴ See WFA/Basin Op. Narr. at III-A-11 to 13.

²⁵ See WFA/Basin Complaint ¶¶ 9-13 (filed Oct. 19, 2004).

²⁶ See Incentive Rate on Coal – Cordero, Wyo, to Smithers Lake, Tex., 358 I.C.C. 537 (1977) (“Smithers Lake”) (finding proposed tariff escalation provision “an unlawful and unreasonable practice”); Coal, Colstrip, Kuehn and Decker, MT to Superior, WI, 364 I.C.C. 152 (1980) (rejecting as unlawful proposed fuel surcharge on unit train tariff rates); Nationwide Increased Freight Rates and Charges, 1977, 359 I.C.C. 312, 316 (1978) (shippers that have not agreed to escalation provisions can separately challenge general rate increases); Increased Freight Rates and Charges, Nationwide – 8 Percent, 359 I.C.C. 740, 742 (1978) (holding down proposed general rate increases on coal tariff rates at the request of involved coal shippers).

Here, BNSF's initial 2005 tariff rates are more than double WFA/Basin's expired contract rates. To determine the reasonableness of BNSF's tariff adjustment procedures, WFA/Basin first ran the LRR DCF model using the initial LRS tariff rates adjusted by quarterly changes in the RCAF-U, starting in 1Q05. The RCAF-U was used to keep the initial LRS rates current with rail price inflation during the DCF period. This run showed LRR revenues exceeding LRR costs²⁷ and demonstrated that the initial LRR tariff rates, adjusted by the RCAF-U, are unreasonable.²⁸ WFA/Basin next ran the LRR DCF model using BNSF's initial tariff rates adjusted using the tariff adjustment procedures. This second run showed LRR revenues exceeding LRR costs by \$500 million more than the first run.²⁹

BNSF's attempt to impose its complex rate adjustment provisions constitutes an unreasonable practice in this case.³⁰ BNSF's initial tariff rates, adjusted by the RCAF-U, produce unreasonably high rates. It is manifestly unreasonable – and an unreasonable practice – to use an adjustment procedure to lop \$500 million in additional payments on top of tariff rates that are already unlawfully high.

Where a carrier's tariff adjustment procedure is unlawful, the proper remedy for DCF purposes is to substitute an appropriate forecast procedure.³¹ Here, WFA/Basin adjust the initial LRS tariff rates by forecasted changes in the RCAF-U. Use of the RCAF-U forecast is

²⁷ See WFA/Basin Op. Narr. at III-A-13 to 1; WFA/Basin Reb. Narr. at III-A-20.

²⁸ See Xcel I at 36 (rates are unreasonable if SARR revenues exceed SARR costs).

²⁹ See WFA/Basin Op. Narr. at III-A-13 to 14; WFA/Basin Reb. Narr. at III-A-20.

³⁰ See 49 U.S.C. §10702 (carrier practices must be reasonable); 49 U.S.C. §10701(d)(1) (rates on market dominant rail traffic must be reasonable); Smithers Lake, supra.

³¹ See APS I at 391 (STB substitutes reasonable adjustment procedure for carrier-sponsored adjuster); WFA/Basin Op. Narr. at I-30 to 32, II-A-13 to 14.

supported by precedent³² and keeps BNSF more than whole for projected LRR cost increases. Also, BNSF must be ordered not to take any other adjustments in LRS prescribed rates (including fixed rate increases, fuel surcharges, the RCAF-U, or any other form of rate adjustment). The DCF model forecasts all costs the LRR needs to recover, including LRR fuel costs. These costs are fully recovered in the LRS SAC rates. Any further adjustments to these prescribed SAC rates would unlawfully double-charge WFA/Basin.

VII. BNSF'S DIVERSIONARY TACTICS

BNSF repeatedly attempts to divert the Board's attention by raising irrelevant side-bar issues. These side-bar issues include BNSF's claims that the Board should set high rates on the LRS traffic because BNSF is "revenue inadequate;" because BNSF needs to set rates at Revenue Shortfall Allocation Method ("RSAM") levels; because BNSF has behaved in a "commercially reasonable" manner; because WFA/Basin is "gaming" the system; etc.

BNSF's contentions are wrong. The Board's SAC standards factor-in BNSF's revenue needs;³³ RSAM is not a SAC standard;³⁴ BNSF's proposed imposition of a \$1 billion rate increase is not "commercially reasonable;"³⁵ and WFA/Basin are not "gaming" the process by seeking regulatory relief from BNSF's outrageous monopoly pricing tactics.³⁶ BNSF's contentions are also irrelevant. BNSF raises these issues to divert the Board's attention away

³² See Xcel I at 55; TMPA I at 27 n.69.

³³ See WFA/Basin Reply Narr. at I-7 to 9.

³⁴ See id. at I-9 to 10.

³⁵ See id. at IV-1 to 10; WFA/Basin Reb. Narr. at III-H-5 to 13.

³⁶ See WFA/Basin Reb. Narr. at IV-2.

from properly deciding the relevant issues in this case – the maximum SAC rates under the Guidelines.

CONCLUSION

The Board is “the guardian of the general public interest, with authority to see that this interest is at all times effectively protected.”³⁷ On behalf of the rural customers served by LRS, WFA/Basin respectfully request the Board to grant the rate relief and reparations they jointly request in their Complaint and in their evidentiary submissions to the Board.

Respectfully submitted,

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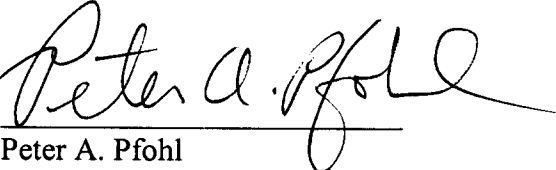
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³⁷ Xcel II at 10 (internal quotations omitted).

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of December, 2005, I caused a copy of the foregoing Brief of Complainants Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. to be served by hand delivery on counsel for BNSF, as follows:

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