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April 5, 2004

Via HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423



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APR 05 2004

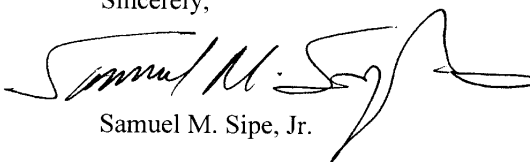
Re: **STB Docket No. 42057, *Public Service Company of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Railway Company*** Part of Public Record

Dear Secretary Williams:

Enclosed for filing in the above-captioned matter are the original and ten copies of the Post-Argument Brief of The Burlington Northern and Santa Fe Railway Company. Please note that this filing includes color documents.

Please date stamp the extra copy of the referenced pleading and return it with our messenger. If you have any questions regarding this matter, please contact the undersigned.

Sincerely,



Samuel M. Sipe, Jr.

Enclosures

cc: Counsel for Complainant

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**PUBLIC SERVICE COMPANY OF
COLORADO d/b/a XCEL ENERGY,**

Complainant,

v.

**THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY,**

Defendant.



Docket No. 42057

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Public Record

**POST-ARGUMENT BRIEF OF DEFENDANT
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY**

In an order served March 19, 2004, the Board directed the parties in this case to file post-argument briefs addressing three issues:

1. What adjustments the Board should make to operating expenses and road property investment if it relies on an operating plan predicated on a traffic group that differs from the traffic group selected by the Board;
2. Whether there are alternatives to RCAF-A and RCAF-U for projecting future operating costs; and
3. How the Board should compute maximum reasonable rates if SAC revenues exceed SAC costs.

Defendant The Burlington Northern and Santa Fe Railway Company ("BNSF") addresses these issues below.

**I. THE NEED FOR ADJUSTMENTS TO OPERATING EXPENSES AND ROAD
PROPERTY INVESTMENT**

The Board's first question to the parties involves a scenario in which the Board accepts one party's operating plan but does not accept in its entirety the traffic group that that operating plan was designed to serve. The Board seeks guidance on how SAC costs should be calculated under those circumstances.

Where the record before the Board contains evidence on an issue that is reliable and probative, the Board should base its decision on the best evidence in the record.¹ In the instant case, adherence to the best evidence rule will limit substantially any adjustments that might be needed to conform the operating plan and traffic grouping assumptions used by the Board to carry out the SAC analysis. The operating plan presented by BNSF based on the RTC model is the best evidence in the record concerning operations of the SARR; indeed, it is the *only* operating plan presented in this case that provides for feasible SARR operations. Applying the best evidence rule, the Board should reject the operating plan submitted by Xcel. Moreover, as explained below, rejection of Xcel's operating plan will resolve in BNSF's favor the most significant traffic issue in this case – *i.e.*, whether the rerouted Western Resources' Jeffrey traffic can be included in the SAC analysis – and therefore will minimize the need for adjustments to BNSF's calculation of SARR operating costs and investments.

The parties disagree as to the appropriateness of including certain movements in the SARR traffic group. *See* BNSF Final Brief at 11-18. The single most important movement on which the parties disagree is the Jeffrey movement, which Xcel purports to reroute onto the SARR from its real world route. The other traffic issues do not involve rerouted traffic but rather involve disputes over the reliability of Xcel's traffic forecasts. Among the grounds on which BNSF proposes to exclude the Jeffrey traffic is the fact that the SARR would not provide service on the Jeffrey movement that is as good as the service provided by BNSF in the real world.²

¹ *See, e.g., Wisconsin Power & Light Co. v. Union Pac. R.R. Co.*, STB Docket No. 42051, at 17, 21 (served Sept. 13, 2001) (applying best evidence of record standard).

² The Jeffrey traffic also should be excluded from the traffic group due to contract requirements and because that traffic does not in the real world share the facilities used by the SARR to handle the issue traffic. The non-issue Jeffrey traffic cannot properly be asked to contribute to the cost of facilities that it does not use.

Xcel agrees that a complainant *cannot* reroute traffic onto the SARR if the SARR would provide inferior service. Xcel had the burden to demonstrate that service provided by its SARR on the rerouted Jeffrey traffic would not be inferior.

BNSF presented extensive evidence that the SARR service for Jeffrey trains would be inferior. BNSF demonstrated that under Xcel's operating plan, the Jeffrey movement would be rerouted over a longer SARR route that would require the Jeffrey trains to maneuver through a crowded section of the central PRB where numerous empty and loaded trains enter and leave the SARR mainlines. The Jeffrey trains' real world route through Edgemont, SD, avoids the potential bottlenecks on the SARR.

The only evidence that could possibly support the inclusion of the Jeffrey movement under these circumstances would be operating evidence demonstrating that the SARR could provide at least the same level of service as the incumbent. However, if Xcel's operating plan is rejected, as it should be, there would be no evidence in the record that could support such a showing.³ Therefore, a finding that Xcel's operating plan is inadequate – the only conclusion that could be reached on this record – necessitates a finding that Xcel has not met its burden of showing that the SARR will provide service on the Jeffrey movement as good as or better than that provided by the incumbent.

Other than the Jeffrey issue, the traffic group disputes in this case do not turn on the service level that the SARR would offer and would not, therefore, necessarily be resolved in

³ Xcel's opening operating evidence, a product of its flawed string program, did not support such a showing. BNSF demonstrated in its reply evidence that the cycle times on the Jeffrey movement developed in Xcel's opening operating evidence were substantially longer than those on the real world BNSF. See BNSF Rep. Nar. at III.A-24 to 27. Xcel claimed that its rebuttal string program produced faster cycle times, but the rebuttal string program was also flawed. Among other things, it ignored grade and curvature on the SARR. See BNSF Final Brief at 17.

BNSF's favor if the Board rejects the operating plan submitted by Xcel. If the Board were to accept BNSF's operating plan and also were to determine that some of the traffic that BNSF excluded on non-service grounds should be included in the traffic group, there would be an evidentiary disconnect in that the evidence presented by BNSF on the capacity and operating costs would be predicated on a different traffic group from that selected by the Board as the basis for its SAC calculations.

In past cases, the Board has made adjustments to operating costs to account for relatively small changes in traffic volumes. However, the need to adjust the SARR's capacity to accommodate efficiently the traffic included in the stand-alone shipper group is a more complex undertaking. The RTC model is capable of assessing whether an assumed track configuration is adequate to handle incremental increases in traffic volume. However, certain assumptions must be made to run the RTC model using a larger traffic base. For example, assumptions must be made as to the number of trains added to the SARR network, the times at which the additional trains come on the SARR, and the characteristics of the added trains.

There are legal limits on the ability of the Board to create new evidence that would provide the basis for a Board decision in an adjudicated matter. The Board would effectively eliminate the complainant's burden of proof if it were to create evidence to compensate for deficiencies in the complainant's SAC presentation. Moreover, an appellate court could question whether a Board decision was supported by substantial evidence if that evidence was created by the Board itself to justify the Board's decision. Apart from these legal considerations, the practical effect of an attempt by the Board to carry out a new capacity analysis for the SARR based on a significantly different traffic group would be to complicate SAC cases even more by inviting disputes over the Board's assumptions.

For the foregoing reasons, if and when the Board determines that the record does not contain adequate evidence to support a decision, the Board should seek additional evidence from the parties. The Board has followed this approach in several recent decisions where it reopened the record for limited submission of supplemental evidence in identified areas where the record was inadequate.⁴ However, BNSF does not believe that this option is available to the Board when the deficiency in the record stems from the failure of the complainant to meet its burden of proof. In such a case, the proper course is to decide the case against the complainant.⁵

II. THE BOARD SHOULD APPLY THE RCAF-U IN THIS PROCEEDING AS THE BEST EVIDENCE ON THE QUESTION OF OPERATING COST INFLATION

The Board is not precluded from accepting in a future case probative and reliable evidence different from the RCAF-U and RCAF-A for projecting future operating costs. There is no such evidence in the record of this case, however. Here, as in prior cases, the parties have framed the dispute as one between these two RCAF indices. On this record, there is no basis for departing from the Board's consistent findings that, as between these two indices, the RCAF-U is superior.

The Board has stated that if the complainant, who bears the burden of proof, believes that the SARR it has posited will achieve meaningful productivity gains over the 20-year DCF period, it must present substantial and competent evidence as to the source of those productivity improvements, the likely time frame, the costs to obtain the improvements and the impact on

⁴ See *Duke Energy Corp. v. CSX Transp., Inc.*, STB Docket No. 42070, and *Carolina Power & Light Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42072 (jointly served Oct. 14, 2003); *Duke Energy Corp. v. Norfolk S. Ry. Co.*, STB Docket No. 42069 (served Oct. 10, 2003).

⁵ In denying BNSF's earlier motion to dismiss in this case, however, the Board determined – incorrectly, in BNSF's view – to let Xcel proceed despite the obvious deficiencies in its operating evidence.

SARR operations.⁶ It would be improper for the Board to presume any productivity gains for the SARR in the absence of competent evidence on future productivity submitted by the party that bears the burden of proof.

Post-argument briefs are not an appropriate vehicle for presenting new evidence on the complex issue of whether the SARR will realize some productivity gains that affect future operating costs or the resources that would be required to create such productivity gains. The Board's procedures in SAC litigation recognize the complexity of SAC issues and therefore provide the parties with months to prepare opening and reply evidence. The question of cost inflation likely to be experienced by the SARR is no less complex or important than many other SAC issues that require significant evidentiary development by the parties.

The Board should therefore limit its consideration of the operating cost inflation issue in this case to the alternatives that have already been presented by the parties in their respective evidentiary filings. There are only two alternatives before the Board in this proceeding. Xcel advocates the use of the RCAF-A to index operating costs over the DCF period. Xcel's argument is that the RCAF-A is appropriate because it is reasonable to assume that the SARR will realize *some* productivity over the 20-year DCF period. Xcel Final Brief at 32. But vague speculation that the SARR is likely to experience some productivity in the future cannot support use of the RCAF-A beginning at the outset of the DCF period. The RCAF-A has nothing to do with the productivity that a hypothetical, optimally efficient SARR could expect to achieve. Projections of the RCAF-A anticipate inflation adjusted to account for productivity improvements expected to be realized by the existing railroads in the future. There is no reason

⁶ See *Duke Energy Corp. v. Norfolk S. Ry. Co.*, STB Docket No. 42069, at 37 (served Nov. 6, 2003) ("*Duke/NS*"); *Texas Municipal Power Agency v. The Burlington N. and Santa Fe Ry. Co.*, STB Docket No. 42056, at 161 (served Mar. 21, 2003) ("*TMPA*").

to believe that those expected productivity improvements bear even the slightest resemblance to productivity improvements that the SARR might achieve.

The Board has correctly recognized that an estimate of future productivity improvements would substantially overstate any conceivable productivity improvements that could be expected by a new, hypothetically efficient railroad that enters the market with brand new assets and new technology:

While it is difficult to imagine that there would not be some areas in which the [SARR] might realize productivity improvements over the course of the SAC analysis period, the potential impact of such improvements is far less than it would be for existing railroads, which make changes incrementally as older technology assets wear out or become obsolete. Thus, it would not be appropriate to use the RCAF-A here.⁷

Accordingly, the Board has concluded that in the absence of specific evidence on productivity gains that a hypothetical SARR could expect to realize, the RCAF-U is the most appropriate inflation index to use in a SAC analysis.⁸ In this case, the only evidence on productivity gains that the SARR might realize relates to information technology. Xcel suggests that the SARR's reinvestment in information technology in five years might result in more productive IT equipment, but Xcel makes no attempt to show how a new generation of IT equipment would affect the SARR's operating costs. Xcel Final Brief at 32. Indeed, the SARR's IT budget is such a miniscule portion of the SARR operating costs that any productivity gains in that area, even if they could be quantified, would have only a *de minimis* effect on the SARR's operating costs. Xcel also speculates about the possibility of more efficient locomotives

⁷ *Carolina Power & Light Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42072, at 27-28 (served Dec. 23, 2003) ("*CP&L/NS*").

⁸ See *Duke Energy Corp. v. CSX Transportation, Inc.*, STB Docket No. 42070, at 30 (served Feb. 4, 2004) ("*Duke/CSX*"); *CP&L/NS* at 27-28; *Duke/NS* at 37; *TMPA* at 161.

in the future, but such efficiencies, if they were to come about, could only be achieved through additional locomotive investments that are not accounted for in Xcel's SAC analysis.

The forecasted RCAF-U properly accounts for future inflation of SARR operating costs. In a SAC case, the complainant posits a hypothetical, least-cost, efficient railroad that achieves at its inception state-of-the-art railroad productivity. Recent SAC cases have applied the "least-cost, efficient railroad" standard in a way that produces SARR operating costs that are orders of magnitude lower than the costs that have ever been achieved by even the most efficient real world railroads. As shown in Exhibit 1 to this Post-Argument Brief, the SARR in this case is assumed to have operating costs as calculated by BNSF that are about half of the costs experienced by the most efficient of the existing Class I railroads. (Exhibit 1 was presented to the Board as a counsel exhibit in the March 18, 2004, argument.)

The very low starting point for SARR operating costs justifies use of the RCAF-U regardless of the possibility of future productivity improvements. The SARR's low early year operating costs indicate that the SARR has already taken full advantage of any meaningful productivity improvements that might be available to the rail industry in the near term. Therefore, any additional productivity gains could not be expected to be realized by the SARR until late in the DCF period, if at all. But changes in the inflation index in the last few years of the DCF would not significantly affect the SAC results. Moreover, the Board has made clear that it is reluctant to base its SAC calculations on predictions of developments far into the future that are inherently speculative. These considerations support continued use of the RCAF-U to adjust future operating costs given the record in this case.

III. THE BOARD SHOULD NOT DEPART FROM ITS PERCENT REDUCTION METHODOLOGY IN THIS CASE

The question as to how the Board should compute maximum reasonable rates if SAC revenues exceed SAC costs has both a theoretical and a practical dimension. On the theoretical level, the Board has identified the troubling possibility that while the outcome of a SAC analysis may determine the issue of reasonableness, it may provide little or no reliable guidance as to the maximum level at which the issue traffic rate should be set. This concern suggests that in an appropriate context the Board may need to reexamine its prescription methodology. On the practical level, however, there is no apparent need at this juncture of this particular case for the Board to consider departing from the percentage reduction method that it has consistently used in prior cases.

The contours of the theoretical dimension of the rate reduction issue were identified in the Board's recent *CP&L/NS* decision. There the Board concluded that the percentage reduction approach was susceptible to manipulation by both the defendant railroad and the complaining shipper.⁹ The possibility for manipulation on the defendant carrier's side was described as follows:

[W]hen a railroad expects a rate to be challenged, it can set the rate at a higher level than it expects to sustain, so that the resulting reduced rate is to its liking.¹⁰

And, on the complaining shipper's side:

Given a traffic group with sufficiently highly rated non-issue traffic, the percent reduction approach could brand any rate level established by a defendant railroad as unreasonable. . . . This potential could encourage a shipper to challenge an otherwise reasonable rate, or enable a shipper to obtain an inordinate rate

⁹ *CP&L/NS* at 31.

¹⁰ *Id.*

reduction, simply by selecting a traffic group with much higher-rated traffic.¹¹

Where the shipper's traffic group is dominated by cross-over movements and the shipper has used a revenue allocation procedure that gives the SARR a disproportionate share of the revenue, the shipper has effectively "select[ed] a traffic group with much higher-rated traffic." The problem is acute when the issue traffic revenues are dwarfed by the total revenues in the stand-alone shipper group. In such instances, the rate reductions proposed by shippers are driven almost entirely by the divisions assumed on cross-over movements. The outcome of the case sought by the complainant has essentially nothing to do with the level of the issue traffic rate; therefore, the magnitude of the difference between revenues and costs says nothing meaningful about the level at which the issue traffic rate should be set.

If the Board were to conclude that manipulation of rate levels and/or traffic groups has become so widespread as to undermine the validity of the SAC test, then the Board should consider whether significant modifications to the SAC test are required or whether a different approach to determining maximum reasonable rates is appropriate. There would be no point in revising the mechanics of the rate prescription methodology if the underlying comparison of revenues and costs itself is flawed. The objective of any such revision to the underlying standard would be the promotion of legitimate differential pricing, recognizing that revenue inadequate railroads need to charge rates at least as high as the unadjusted RSAM level on demand inelastic movements to make progress towards the statutory goal of revenue adequacy.

Such an inquiry into alternative standards would not be appropriate in the context of an individual rate case. A rulemaking proceeding would be the proper context in which to investigate issues of such far reaching consequence.

¹¹ *Id.*

As to the practical dimension of the issue – the possible implementation of a rate reduction approach in this case – BNSF does not believe that there is any basis at this juncture of the proceeding to consider a departure from Board precedent.¹² Indeed, it would be inappropriate to think that the outcome of the Board’s SAC analysis here will provide any basis for a rate prescription. BNSF firmly believes that the best evidence of record will show costs in excess of revenues.

BNSF has not alleged that manipulation of the traffic group by Xcel should lead to the abandonment of the percentage reduction approach in this case. BNSF has contended – and indeed has demonstrated – that Xcel’s excessive reliance on cross-over traffic is improper and has the potential to distort the outcome of the SAC analysis. The Board’s resolution of those issues will determine whether a departure from the percentage reduction method should be considered at a subsequent stage of this proceeding.

Xcel has alleged manipulation in the setting of the rates by BNSF but has presented absolutely no evidence to support that contention. There has been no massive increase in rates here. As discussed by BNSF at the argument, the common carrier rate at issue in this case involves only a modest increase over the rate in the expiring contract. Chairman Nober has recently acknowledged that one would expect a common carrier rate to be somewhat higher than a negotiated contract rate. *See* Statement of Chairman Nober, *Duke Energy Corp. v. CSX Transportation, Inc.*, STB Docket No. 42070, (Sept. 10, 2003). Conversely, the commitments provided by shippers in a contract can be expected to produce somewhat lower rates than common carrier rates. Here, the modest difference between the expiring contract rate and the

¹² The Board has held that applying a percentage reduction is the preferred method for calculating maximum reasonable rates when SAC revenues exceed SAC costs. *TMPA* at 14.

challenged common carrier rate does not begin to approach the massive rate increases that prompted concern over possible manipulation in the *CP&L/NS* case.

Moreover, even with the higher common carrier rate now charged for movements to the Pawnee plant, the combined rate for transportation to Xcel's Comanche and Pawnee plants is now lower than the bundled rate was under the expired contract. Exhibit 2 to this filing – a copy of the “Rate Comparison: Contract and Post-Contract” slide used at oral argument – illustrates the overall decrease in rates that Xcel has enjoyed. A decrease in overall rates can hardly be used to justify a departure from the Board's established methodology.

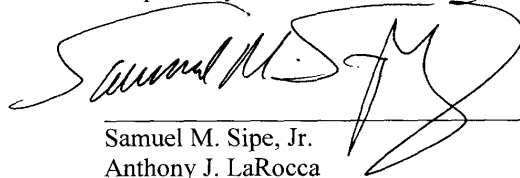
Even if there were a basis in the record in this case to depart from the percentage reduction methodology, Xcel has failed to offer a viable alternative approach despite having the opportunity to do so. Xcel suggested two possible alternatives in its reply evidence: (1) use the rates offered by BNSF in contract negotiations; or (2) rely on a calculated SAC cost per ton-mile. Xcel Rep. Nar. at II-A-147. Both approaches have been rejected by the Board. As to the first approach, the Board explained in *CP&L/NS* that it would not be “sound public policy to base a rate prescription on the last contract offer, as such a policy would chill good-faith rate negotiations.” *CP&L/NS* at 32. As to the second approach, Xcel itself admits that the approach has been rejected. Xcel Rep. Nar. at II-A-148. The Board explained in *CP&L/NS* that the “ton-mile approach would not allow for demand-based differential pricing.” *CP&L/NS* at 33. The Board explicitly recognized that shippers like Xcel with highly inelastic demand must pay relatively higher rates.

In short, Xcel has not made out a case for an alternative rate reduction methodology. Nothing that it might propose in the context of post-argument briefing would constitute evidence

of record sufficient to justify a departure from the Board's existing rate prescription methodology.

While not advocating a departure from the percentage reduction approach here, BNSF points out that an additional step must be taken in the Board's SAC analysis before any final rate prescription could be made. As BNSF explained at the March 18, 2004 oral argument, the Board should undertake a cross-subsidy analysis of the sort that was performed in the Board's decision in *PPL Montana, LLC v. The Burlington N. and Santa Fe Ry. Co.*, STB Docket No. 42054 (served Aug. 20, 2002), before any maximum reasonable rate can be identified for the issue traffic. That analysis would have to be carried out after the Board makes its decision on the disputed SAC cost and revenue issues. In this case, the cross-subsidy analysis would assure that the reduced rates (including the issue traffic rate) that might be imposed on traffic using the segment of the SARR from Northport, NE, south to the Pawnee generating station would not be reduced below the level needed to cover the collective attributable costs of constructing and operating over that segment of the SARR.

Respectfully submitted,



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April 5, 2004

CERTIFICATE OF SERVICE

I hereby certify that on April 5, 2004, I caused a copy of the foregoing Post-Argument Brief of Defendant The Burlington Northern and Santa Fe Railway Company to be served by hand upon the following counsel for Public Service Company of Colorado d/b/a Xcel Energy:

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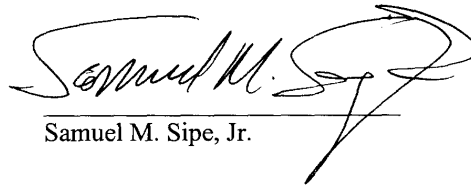
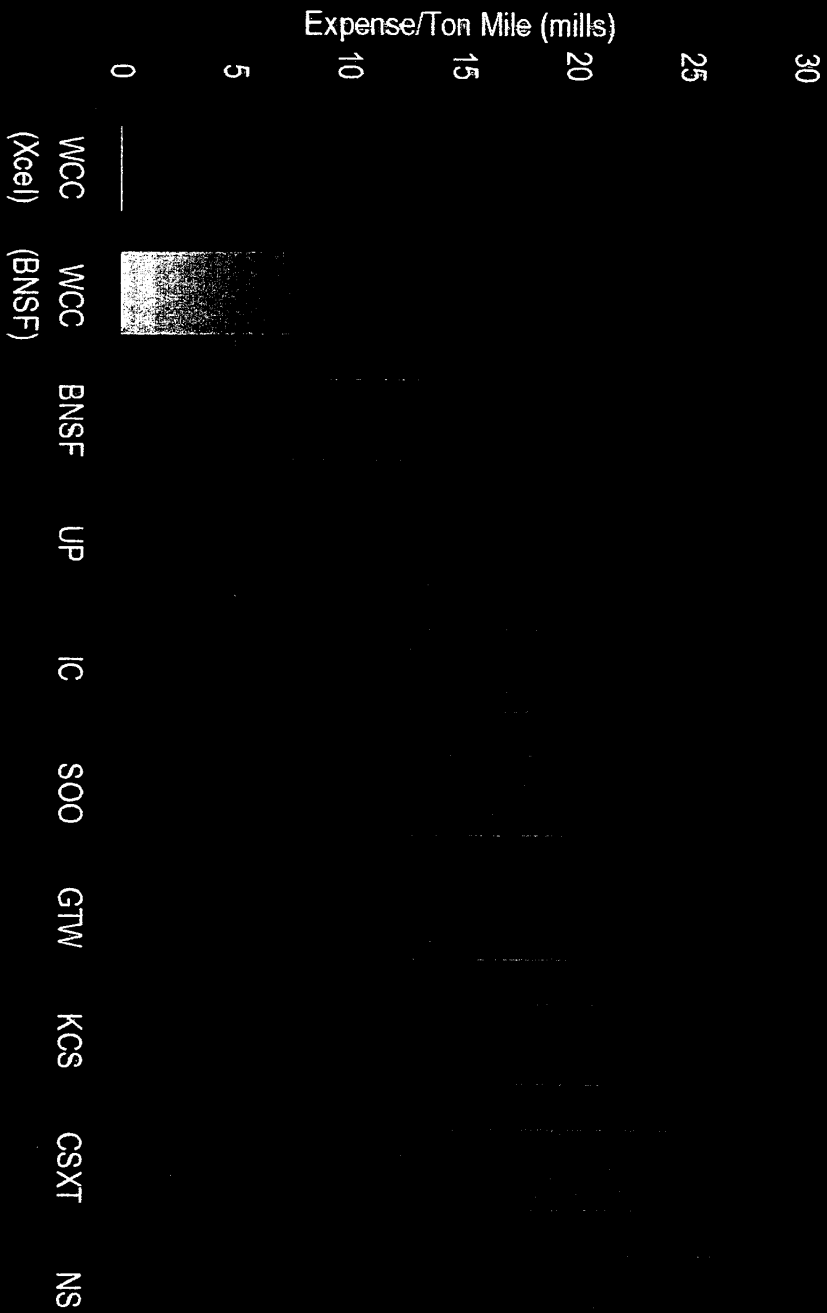

Samuel M. Sipe, Jr.

EXHIBIT 1

EXHIBIT 1

2001 Operating Expense Per Ton Mile (mills) Class I Railroads



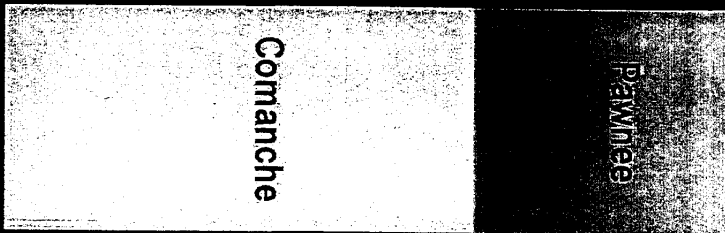
* The Source for Class I data is *Analysis of Class I Railroads 2001*

EXHIBIT 2

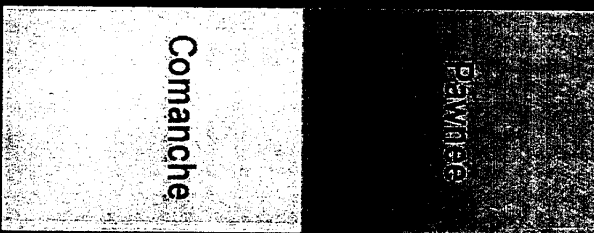
Rate Comparison Contract and Post-Contract

Rate Per Ton

Contract
Rates



Post-Contract
Rates



*Actual rates/ton not shown due to confidentiality