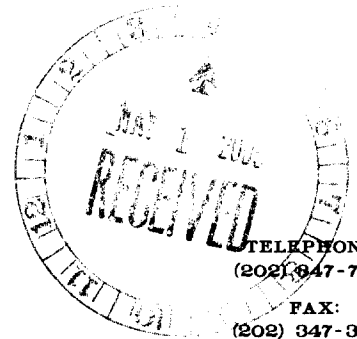


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May 1, 2006

WRITER'S E-MAIL:

BY HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D. C. 20423

Re: Docket No. 42088, *Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company*; Ex Parte No. 657 (Sub-No. 1), Major Issues in Rail Rate Cases

Dear Secretary Williams:

Enclosed for filing are the original and ten copies of the Additional Opening Comments of Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. in the above-referenced proceedings. Three CDs containing the electronic version of these Comments are also included.

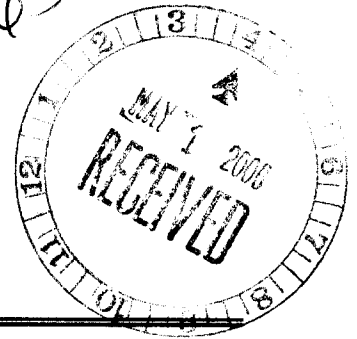
Kindly acknowledge receipt of the enclosed pleading by date-stamping and returning the enclosed extra copy of this letter to our messenger.

Sincerely,

John H. LeSeur

cc: Counsel for BNSF
Parties to Service List

716 465



Ex Parte No. 657 (Sub-No. 1)

STB Docket No. 42088

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

	)	
	)	
MAJOR ISSUES IN RAIL RATE CASES	)	Ex Parte No. 657 (Sub-No. 1)
	)	
	)	
WESTERN FUELS ASSOCIATION, INC.	)	
and BASIN ELECTRIC COOPERATIVE, INC.)	)	STB Docket No. 42088
v. BNSF RAILWAY COMPANY	)	
	)	

**ADDITIONAL
OPENING COMMENTS
OF
WESTERN FUELS ASSOCIATION, INC. AND
BASIN ELECTRIC POWER COOPERATIVE, INC.**

Western Fuels Association, Inc. ("WFA") and Basin Electric Power Cooperative, Inc. ("Basin Electric")¹ join in the Joint Comments filed by the Coal Shippers.² WFA/Basin file these additional comments to address application of the Board's Notice³ to their pending rate case, STB Docket No. 42088 ("Western Fuels"). As discussed in detail below, WFA/Basin request that the Board promptly and finally decide their maximum rate reasonableness case in a manner that comports with the law

¹ WFA Basin Electric are collectively referred to as WFA/Basin.

² Joint Opening comments of Western Coal Traffic League, Concerned Captive Coal Shippers, Western Fuels Association, Inc., Edison Electric Institute, National Rural Electric Cooperative Association and American Public Power Association.

³ Ex Parte No. 657 (Sub No. 1), Major Issues in Rail Rate Cases (STB Notice served Feb. 27, 2006) ("Notice").

and the substantial record evidence WFA/Basin have presented to the Board demonstrating that they are entitled to substantial coal rate reductions and refunds. All of this relief will flow through to electric consumers.

BACKGROUND

A. Identity and Interest

WFA is a non-profit fuel supply cooperative corporation headquartered in Denver, Colorado. WFA's members consist of 19 consumer-owned utilities, including rural electric generation and transmission cooperatives, municipal utilities and other public bodies. WFA exists to assist its members in obtaining coal, and coal transportation, at reasonable delivered prices. WFA pursues those objectives in many ways, including the management (through affiliated companies) of some coal mines, the management of a private rail car fleet, and the purchase of coal, and coal transportation, on behalf of some of its members.

Basin Electric, like WFA, is a non-profit organization. Basin Electric is a regional consumer-owned wholesale electric generation and transmission cooperative. Basin Electric is headquartered in Bismarck, North Dakota. Basin Electric generates and transmits electricity to 120 member rural electric systems in nine states.⁴ These systems in turn distribute electricity to 1.8 million people. Basin Electric's mission is to provide

⁴ These nine states include Colorado, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, South Dakota and Wyoming.

cost-effective wholesale energy and related services to its members. To accomplish this objective, Basin Electric has ownership interests in, and operates, electric generating facilities in North Dakota, South Dakota and Wyoming. WFA/Basin are filing comments in this proceeding on behalf of the owners of the Missouri Basin Power Project.

The Missouri Basin Power Project, a group of six cooperative and other public power providers (including Basin Electric), owns the Laramie River Station ("LRS") and adjacent facilities. LRS, located near Wheatland, WY, is one of the largest consumer-operated, regional joint supply ventures in the United States. Basin Electric serves as the Project's operating agent. The other five participants in the Project are:

Heartland Consumers Power District, Madison, SD, a public power district serving South Dakota agencies and municipal electric systems in South Dakota, Iowa, and western Minnesota.

Lincoln Electric System, Lincoln, NE, the largest municipally owned electric system in the Missouri Basin.

Tri-State Generation and Transmission Association, Inc., Denver, CO, a wholesale power supplier for 44 rural electric cooperatives in western Nebraska, northeastern Colorado, New Mexico and much of Wyoming.

The Western Minnesota Municipal Power Agency, Ortonville, MN, a group of municipally owned electric systems in Minnesota which are represented in the Project by the Missouri River Energy Services, Sioux Falls, SD.

The Wyoming Municipal Power Agency, Lusk, WY, a group of municipally owned electric systems organized to develop an additional power supply source above their present allocations from the U.S. Bureau of Reclamation.

LRS is a base load facility comprised of three coal-fired units, each with 550 megawatts of capacity. Units 1, 2 and 3 began operating in 1980, 1981 and 1982, respectively. LRS was constructed for a cost of approximately \$1.6 billion and is designed to burn low-sulfur Wyoming Powder River Basin ("PRB") coal. Currently, LRS receives over eight million tons of PRB coal annually in unit coal train service.

Basin Electric has longstanding arrangements with WFA calling for WFA to obtain coal and coal transportation for LRS. Basin Electric reimburses WFA for LRS coal transportation charges WFA incurs. The ultimate payors of these transportation charges are the electric cooperative, municipal, and public power customers that receive power generated by LRS.

B. The Western Fuels Case

LRS is served by a single rail carrier – the BNSF Railway Company ("BNSF"). BNSF has provided coal transportation services from the PRB to LRS since LRS began commercial operations. In October of 2004, BNSF imposed massive, unprecedented rate increases on the LRS traffic. If left unchecked, these increases will exceed \$1 billion over the next twenty years.

BNSF's unprecedented price gouging 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.⁵

Left without any other alternatives, WFA/Basin turned to the STB as its last line of defense against BNSF's monopoly pricing abuses. On October 19, 2005, WFA/Basin filed a complaint at the STB challenging BNSF's tariff rates. In its Complaint, WFA/Basin implored the Board to resolve its case on an expedited basis:

WFA and Basin respectfully request that the Board do all it can to expedite this rate case. BNSF's common carrier rates impose draconian rate increases over the contract rate levels previously in effect. On information and belief, Complainants are aware of no shipper that has been forced to incur such immediate, massive rate increases. For example, the percentage increases vastly exceed those that the Board considered in its recent eastern coal rate case decisions. Not only are the increases unprecedented, but the resulting rates, when measured on a cost-of-service basis, or on a mills per ton-mile basis, are vastly in excess of

⁵ Their statements are included in Exhibits IV-B-1 through IV-B-10 of WFA/Basin's Opening Evidence in the Western Fuels case.

the maximums the Board has prescribed in its recent western coal case decisions. Expedition is particularly important since, under the present regulatory scheme, Complainants have no choice but to pay the exorbitant rates during the pendency of this case.

Id. at ¶12.

WFA/Basin proceeded with the daunting – and extraordinarily expensive – task of putting on a stand-alone cost (“SAC”) case. WFA/Basin’s evidence included 26 witnesses; over 1,200 pages of written narrative; 116 exhibits consisting of over 1,050 pages; 7,223 pages of hard-copy workpapers; and numerous CD’s containing of tens of gigabytes of electronic submissions. WFA/Basin’s submission is the most comprehensive SAC evidence ever presented to the Board. This evidence demonstrates that BNSF’s tariff rates vastly exceed the maximum SAC rates and, as a result, WFA/Basin (and the LRS rural customers) are entitled to substantial relief in the form of prescribed rate reductions and refunds.

WFA/Basin also presented its SAC evidence to the Board in record time. The record closed when the parties filed rebuttal evidence on September 30, 2005. Final briefs were filed on December 6, 2005.

C. The Board's Ex Parte No. 657 Proceeding

In February of 2005, the Board instituted its Ex Parte No. 657 proceeding.⁶

This was a Board-initiated proceeding, not one requested by railroads, shippers or any other member of the public. According to the Board, the purpose of the proceeding was to hold a public hearing to obtain an "expression of views" on general SAC issues and was "not intended to offer a forum for discussion of pending cases." Id. at 1-2.

The Board proceeded to hold its public hearing on April 26, 2005. One issue raised at that hearing was whether the Board should institute a rulemaking proceeding to address SAC issues. The shipping community unanimously requested the Board not to institute such a proceeding, citing four interrelated reasons:

- First, the Coal Rate Guidelines clearly provide that complex SAC issues are best left to case-by-case resolution. See Guidelines at 542-43 (SAC computations are "left to the parties to make in each case"). See also PPL Montana, et al. at 5 (Board denied request by BNSF and UP to institute separate proceedings, citing the policy of addressing SAC issues "as they arise in individual adjudications.")
- Second, the SAC standards themselves are not hard-and-fast "rules." See OPPD at 142 (the Guidelines "are styled guidelines precisely because they do not contain rules"). The STB does not need to initiate rulemakings to change guidelines that are not rules. All SAC

⁶ Ex Parte No. 657, Rail Rate Challenges Under the Stand-Alone Cost Methodology (STB served Feb. 16, 2005).

implementation issues can – and should – be addressed in individual cases.

- Third, side-bar proceedings will divert the Board's attention from correcting case-specific SAC implementation issues where they should be corrected – in pending coal rate cases. Many coal rate cases were left in limbo for years as the ICC struggled to develop the Guidelines. Reopening the Guidelines for rulemaking proceedings raises the specter of similar delays and added expense, as coal shipper-complainants get caught in the cross-fire between their cases and the generic rulemaking proceedings.

- Fourth, any SAC-related rulemaking proceedings paralleling pending complaint cases are likely to be complex, time-consuming and expensive. If past is prologue, any STB decisions are likely to be appealed, resulting in further delays and uncertainty. It took the Board's predecessor, the ICC, almost a decade to promulgate the Coal Rate Guidelines, and the appeals took another two years. Shippers have no assurance that any new “rulemaking” proceedings concerning the Guidelines will be on a faster track or produce meaningful results.

Ex Parte No. 657, Subscribing Shippers' Joint Statement of Principles (filed Apr. 20, 2005) (footnotes omitted).

The Board made no statement at the Ex Parte No. 657 hearing, or thereafter, indicating that it disagreed with the unanimous position of the rail shipping community.

D. The Board's Ex Parte No. 657 (Sub No. 1) Proceeding

Some nine months after the Board's Ex Parte No. 657 hearing – and five months after the record closed in the Western Fuels case – the Board, again on its own accord, instituted a rulemaking proceeding it denominated Ex Parte No. 657 (Sub No. 1).

In its Notice, the Board:

- Asks for “comments on proposals we have developed to address six issues that have been raised in recent SAC cases” (id. at 2);
- States that, with regard to its percent reduction, cross-over traffic and operating expense index proposals, the Board proposes “to apply whatever new methodology we adopt (if any)” in the pending Western Fuels and AEP Texas cases (Notice at 2);⁷ states that the Board has “formed no opinion on the equities” of applying its variable cost proposal to the pending Western Fuels and AEP Texas cases (Notice at 2); and states that “absent comments from the parties” the Board does not intend to apply its DCF period proposals to the pending Western Fuels and AEP Texas cases (Notice at 2);
- Asks WFA/Basin and AEP Texas “to comment . . . on whether or to what extent it would be inequitable to apply the changes proposed herein, or parts thereof, to their pending cases” (id.);

⁷ AEP Texas North Co. v. BNSF Railway Co. (STB Docket No. 41191 (Sub No. 1)) (“AEP Texas”).

- Informs WFA/Basin and AEP Texas that if they want the Board to consider “a proposal that [they have] already submitted” in their pending case on percent reduction, cross-over traffic and indexing operating expenses “[they] must submit [their] proposal as comments in the STB Ex Parte No. 657 (Sub No. 1) proceeding” (id.);
- Asserts that the Board is (i) “holding ... in abeyance” the Western Fuels, AEP Texas and KCPL⁸ rate cases (Notice at 2); (ii) is reopen[ing] the record” in the Western Fuels and AEP Texas cases (Notice at 39); and (iii) is “toll[ing (]” the “timeframe for a decision” in the Western Fuels and AEP Texas cases (Notice at 39);
- Establishes a procedural schedule calling for three rounds of comments in Ex Parte No. 347 (Sub No. 1) (id. at 3); states the Board’s intention “to issue our final decision within 120 days after all comments have been received” (id.); and further states that the Board “will [thereafter] issue an order in the AEP Texas and Western Fuels cases regarding the supplemental evidence needed in those cases” (id.); and
- Advises WFA/Basin and AEP Texas that the Board will be issuing a “compliance order” to obtain needed information to address asserted “significant gaps or inconsistencies in the record in these pending cases” (id.).

⁸ Kansas City Power and Light Co. v. Union Pacific Railroad Co. (STB Docket No. 42095) (“KCPL”).

The Board claims that its Ex Parte No. 657 (Sub No. 1) rulemaking proceeding are “designed to ensure that both the SAC test and the jurisdictional floor for rate relief are applied fairly and in conformity with our statutory responsibilities.” Id. at 2. The Board’s Notice makes no reference to the fact that the shipping community expressly asked the Board not to institute a SAC rulemaking proceeding, nor does the Notice explain why the Board waited for nearly a year after its Ex Parte No. 657 hearing to issue its Notice.

On March 20, 2006, a shipper consortium (including WFA/Basin) asked the Board to reconsider, and withdraw, its Ex Parte No. 657 (Sub No. 1) Notice, inter alia, on grounds that the Notice (i) ignored the requests of the shipper community not to institute a rulemaking proceeding; (ii) reneged on the Board’s promise that the Ex Parte No. 657 proceeding “is not intended to offer a forum for discussion of pending cases;” (iii) violated Congressional directives that pending cases be decided in conformity with governing statutory deadlines; and (iv) arbitrarily departed from the Board’s settled practice of deciding SAC cases in individual adjudications. The Board summarily denied this reconsideration petition in a decision (“Reconsideration Decision”) served on April 14, 2006.

E. Compliance Orders

In its Notice, the Board referred to “compliance order[s].” Id. at 2-3. The Board served its compliance order in the Western Fuels case on March 17, 2006

("Compliance Order"). Therein, the Board asserts that WFA/Basin's and BNSF's presentation of Rail Traffic Controller ("RTC") modeling evidence with respect to the SARR's operations is flawed because of the asserted "failure of the parties to present [RTC] evidence that can be compared and matched up against the other party's evidence." Id. at 1. The Board proceeds to direct the parties to re-run the RTC model based upon a composite set of Board-chosen assumptions culled from the parties' filings. The Compliance Order schedule calls for WFA/Basin to present supplemental evidence on May 15, 2006, for BNSF to file reply evidence on June 15, 2006, and for WFA/Basin to file rebuttal evidence on July 14, 2006. On April 21, 2006 the Board denied a request made by BNSF to reconsider the Compliance Order and reduce the Laramie River Railroad's ("LRR")⁹ base year tonnage levels.

SUPPLEMENTAL MATERIAL

The Board's Notice directs WFA/Basin to resubmit evidence they filed in the Western Fuels case concerning rate relief methodologies, revenue divisions for cross-over traffic and indexing of operating expenses, if WFA/Basin want that evidence considered in this proceeding and in their pending rate case. WFA/Basin wants the evidence to be considered. A synopsis of the evidence is set forth in Part I below, and public versions of the evidence WFA/Basin filed on the three-referenced issues are

⁹ The LRR is the name for WFA/Basin's Stand-Alone Railroad ("SARR").

appended in Exhibits to these Comments.¹⁰ The Board also asks for WFA/Basin's comments on the "equities" of applying its proposals, or parts thereof, to the Western Fuels case. WFA/Basin address these issues in Part II below.

I. **RESUBMISSION OF EVIDENCE**

WFA/Basin briefly summarizes their resubmitted evidence as follows:

1. **Alternatives to the Percent Reduction Methodology**

In their opening and rebuttal evidence in Western Fuels, WFA/Basin demonstrated that the percent reduction method for allocating SAC rate relief was unlawful, inter alia, because it transferred the power to set maximum rates from the Board to market dominant rail carriers. WFA/Basin proposed two alternatives to the percent reduction method: the "Reasonable Allocation Method" or "RAM," and the "Reduced Mark-Up" method.

¹⁰ Both "Highly Confidential" and "Public" versions of WFA/Basin's opening and rebuttal evidence were filed with the Board pursuant to the protective order in Western Fuels. To avoid violating the protective order, the exhibits to these Supplemental Opening Comments include excerpts from the "Public" versions of WFA/Basin's evidence. The Board has access to and can review the "Highly Confidential" versions of these materials (including relevant electronic workpapers) filed in Docket No. 42088, and those versions are incorporated herein by reference for purposes of the Board's consideration of WFA/Basin's evidence in this proceeding.

a. RAM

RAM was the principal methodology advocated by WFA/Basin for determining the rate relief to which they are entitled in Western Fuels. RAM makes the defendant railroad's choice of the rate for the issue traffic irrelevant to the determination of a maximum reasonable rate and is fully consistent with the core principles of Ramsey pricing that underlie the Coal Rate Guidelines.

The RAM methodology is explained and applied to determine rate relief for the traffic at issue in WFA/Basin's opening and rebuttal evidence in Western Fuels. The relevant portions of WFA/Basin's opening evidence pertaining to RAM are appended hereto as Exhibit 1A, and the relevant portions of WFA/Basin's rebuttal evidence pertaining to RAM are appended hereto as Exhibit 1B.

Under RAM, all LRR shippers pay their variable costs, calculated using a LRR-specific URCS. RAM then allocates all unattributable SARR costs to the LRR's captive shippers, on a pro-rata basis. All of the captive LRR shippers are PRB coal shippers with demonstrably similar demand elasticities. Application of the RAM methodology is relatively simple and involves a five-step process, as explained at pp. III-H-14 to 15 of WFA/Basin's Op. Narr. (see Exhibit 1A hereto). The steps are summarized as follows:

Step 1 – Calculate LRR Variable Costs. The first RAM step calculates LRR's variable costs for providing service to each LRR traffic group member. WFA/Basin used LRR-specific URCS unit costs to make these calculations.

Step 2 – Calculate LRR Unattributable Costs. The second RAM step calculates the LRR's unattributable costs. The unattributable costs equal the sum of total SAC costs (SAC operating expenses plus SAC road property capital requirements) minus total LRR variable costs calculated under Step 1, above.

Step 3 – Division of Traffic Group. The third step in RAM is to divide the LRR traffic group into two groups: the captive coal shipper group and the competitive coal shipper group. The captive group consists of coal shippers that are captive to BNSF at the traffic destination or at origin by virtue of a long-term coal supply contract. The competitive group consists of coal shippers that enjoy competition (i.e., at least two different carrier sets between origin and destination) and shippers where the BNSF competes with the Union Pacific Railroad Company ("UP") to provide service to an interchange or barge transfer point for movement beyond to a utility destination that is sole-served by a rail carrier other than BNSF or UP or is served by water carrier.

Step 4 – Allocate Unattributable Costs. The fourth RAM step allocates unattributable costs only to the LRR's captive shippers under a prorate approach. The competitive coal shippers make no contribution.

Step 5 – Calculate LRR Shipper Rates. The final RAM step calculates LRR shipper SAC rates. These rates equal the LRR shipper-specific variable costs calculated under Step 1 plus a shipper-specific allocation of unattributable cost calculated under Step 4.¹¹

A more detailed explanation of each of these steps is provided in Exhibit 1A at pp. III-H-22 to 28.

¹¹ RAM also contains a default rule – no shipper is required to pay more than its current rate.

RAM is an appropriate procedure for allocating SAC relief where discrete groups of SARR shippers have similar demand elasticities, as it the case with the captive shippers in the LRR traffic group. RAM does not use the defendant carrier's initial tariff rate as the starting point for determining maximum rate relief, so it removes the principal flaw in the percent reduction method. RAM fully comports with the Coal Rate Guidelines because RAM's fundamental revenue-allocation principle is that captive shippers with similar demand elasticities can pay a pro rata share of the SARR's unattributable costs. RAM is also consistent with the SAC allocation principles applied by the ICC in the first two major coal rate cases decided after the Guidelines were promulgated.¹² Finally, RAM also remedies so-called "shipper gaming" problems because RAM uses a bottom-up approach that sets cost-based SAC rates, not top-down rates where high r/vc ratios on cross-over traffic effect the resulting maximum rate for the complainant shipper.

b. The Reduced Mark-Up Method

In addition to RAM, WFA/Basin presented a second alternative to the percent reduction method to set LRR movement-specific maximum rates: the Reduced Mark-Up method. The Reduced Mark-Up method works in the same form as the percent reduction method, but it corrects the most obvious problem with that method by reducing SARR shippers' profit contributions, not simply their rates. In other words, it provides

¹² See Exhibit 1A at III-H-17 to 28 and Exhibit 1B at III-H-16 to 21.

for each SARR shipper to bear different shares of SAC costs based on the profit contribution of its traffic.

WFA/Basin's evidence with respect to the Reduced Mark-Up method was presented at p. III-H-34 of their Opening Narrative and pp. III-H-33 to 37 of their Rebuttal Narrative (with associated workpapers). These pages are included in Exhibits 1A and 1B hereto, respectively. Using the Reduced Mark-Up method, WFA/Basin calculated the profit contribution by each LRR shipper. 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.

Unlike RAM, the Reduced Mark-up method does not fully solve the "starting rate" problem with percent reduction because the defendant's initial tariff rate still influences the SAC answer. However, the Reduced Mark-up method minimizes the impact of the starting rate because it accords the most relief to shippers such as WFA/Basin that make the highest profit contributions to the LRR. RAM was WFA/Basin's preferred methodology for determining the rate relief to which WFA/Basin are entitled, but they had no objection to the Board's setting the LRS rates using the Reduced Mark-Up method, as calculated by WFA/Basin, if the Board preferred that alternative.

2. Allocation of Revenues for Cross-Over Traffic

In their opening and rebuttal evidence, WFA/Basin developed cross-over revenue divisions using the Modified Straight Mileage Prorate (“MSP”) methodology. As WFA/Basin discussed in their opening and rebuttal filings, the MSP methodology, or its predecessor the Modified Mileage Prorate (“MMP”) method, has been applied in the last nine STB decisions involving cross-over traffic. WFA/Basin also demonstrated that use of the MSP approach was supported by substantial record evidence.¹³

Under established Board precedent in effect at the time WFA/Basin filed their evidence, the burden was on BNSF to demonstrate that it had a superior alternative to MSP. BNSF presented two proposed alternatives: one a modified MSP that reduced the origin and destination mileage blocks to 25 miles and a second so-called “avoidable cost” method that set the LRR’s divisions at BNSF’s unadjusted URCS costs for replicating on-SARR cross-over traffic service.

WFA/Basin presented substantial evidence demonstrating that BNSF had failed to meet its burden of proof. The Board’s subsequent decision in Otter Tail¹⁴ – issued after the record closed in Western Fuels – confirms this result. In Otter Tail, BNSF proposed the same modified MSP method as its proposed in Western Fuels and

¹³ WFA/Basin’s evidence on allocation of revenues for cross-over traffic is reproduced in Exhibits 2A (opening evidence) and 2B (reply evidence) appended hereto.

¹⁴ Otter Tail Power Co. v. BNSF Railway Co., STB Docket No. 42071 (STB served Jan. 27, 2006).

presented the same supporting evidence. The Board in Otter Tail rejected BNSF's modified MSP approach, and set cross-over traffic divisions using MSP. Id. at 15-17. BNSF's "avoidable cost" approach also would be rejected under the Board's Otter Tail analysis.

3. Indexing Operating Expenses

In most prior SAC rate cases the Board has indexed SARR operating expenses using a forecast of the RCAF-U, as advocated by the railroad defendants, rather than a forecast of the RCAF-A, as advocated by the shipper complainants. The Board has chosen the RCAF-U because the Board has concluded that a SARR starts out as an efficient rail carrier and "would not be able to realize the same productivity gains as the rest of the industry, particularly in the early years of the DCF." (Notice at 20). However, the Board has recognized that a SARR will experience some productivity improvements, and that the index used to project a SARR's operating expenses "should reflect some anticipated productivity improvements for the SARR." Id.; see also Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry., STB Docket No. 42057 (STB served June 8, 2004) at 33.

In their opening evidence WFA/Basin proposed that the Board index the LRR's operating expenses by a factor equal to 0.53% of the forecasted changes in the RCAF-U. See Exhibit 3A hereto at III-G-14 to 20. On rebuttal, WFA/Basin used more current Global Insight forecasts of the RCAF-U and the RCAF-A to update their

proposed index to 0.59% of the forecasted changes in the RCAF-U. See Exhibit 3B hereto at III-G-7 to 9. BNSF, on the other hand, proposed to index LRR operating costs using an index that assumed the LRR would achieve no productivity gains through 2014 and only marginal productivity gains thereafter. As discussed in detail in WFA/Basin's rebuttal evidence in Docket No. 42088 (Exhibit 3B), WFA/Basin's procedures to adjust LRR operating costs were demonstrably superior to BNSF's procedures because the 0.59% RCAF-U index provided a far more realistic forecast of the LRR's operating cost increases than BNSF's proposed index.

II. **THE EQUITIES**

The Board asserts in its Notice that it instituted this rulemaking proceeding "to ensure that both the SAC test and the jurisdictional floor for rate relief are applied fairly and in conformity with our statutory responsibilities." Notice at 2. As WFA/Basin, and other coal shippers, emphasized in their Joint Petition for Reconsideration, the Board's assertions ring hollow with coal shippers because the Board's actions:

- Violate its statutory responsibility to decide the Western Fuels case by the governing statutory deadline;¹⁵

¹⁵ The record closed in Western Fuels on September 30, 2005 and final briefs were filed on December 6, 2005. 49 U.S.C. §10704(c)(1) requires the Board to decide the case "within 9 months after the close of the administrative record." See, e.g., Forest Guardians v. Babbitt, 174 F.3d 1178, 1190 (10th Cir. 1999) (where agency "fails to comply with a
(continued...)

- Ignore the unanimous requests of the shipping community not to institute a rulemaking proceeding and not to decide SAC issues in rulemaking proceedings;
- Renege on its assertions that the Ex Parte No. 657 proceeding would not be used to address case-specific issues;
- Arbitrarily require Western Fuels to “resubmit” evidence, already submitted in its rate case, for that evidence to be considered in its case;
- Reopen the record in Western Fuels for what appears to be nine additional rounds of filings: three in response to the Compliance Order; three in response to the Notice, and presumably three rounds of supplemental filings after the Board issues its final rules in this proceeding; and
- Dramatically increases WFA/Basin’s already extraordinarily high litigation costs.

In its decision denying the Joint Petition for Reconsideration, the Board indicated that coal shippers have it wrong. According to the Board, the “centerpiece” of its proposed rulemaking proceedings are its proposal “to address shipper concerns that the existing [percentage reduction] method can be unfairly manipulated by railroads.” Reconsideration Decision at 2. The Board also stated that shippers asserted “failure” to present acceptable alternatives to percent reduction in the two pending cases “was a

¹⁵(...continued)
 statutorily imposed absolute deadline, it has unlawfully withheld agency action”.

particular concern.” Id.¹⁶ Thus, the Board portrays the instant proceeding as one that is intended to help – not hurt – coal shippers with pending cases.

The Board, as it knows, is proposing to retroactively apply new rules in Western Fuels and AEP Texas cases. While the Board asserts this approach is legal,¹⁷ the Board expresses concerns about the “equitable” problems with its retroactive actions and asks WFA/Basin and AEP Texas to address the “equities” of applying all or part of its proposals in the two pending rate cases. WFA/Basin will address these “equities” with respect to its pending case.

- Alternatives to Percent Reduction. WFA/Basin demonstrated in their evidentiary submissions that the Board’s percent reduction methodology is flawed and unlawful because the defendant carrier’s starting rate dictates the resulting SAC answer.

The Board agrees with this conclusion in its Notice:

A critical problem with the percent reduction approach – which has been brought to light in recent SAC cases – is that a railroad could manipulate the outcome of the Board’s regulatory process.

¹⁶ The Board offers no explanation why it came to this asserted conclusion.

¹⁷ The Board claims that “the choice between rulemaking and adjudication lies in the first issuance within the [agency’s] discretion.” Id. at 2. However, in cases governed by a statutory deadline, an agency cannot lawfully toll the deadline by claiming it must first complete an on-going rulemaking proceeding. See Am. Tel. and Tel. Co. v. FCC, 978 F.2d 727, 732 (D.C. Cir. 1993). WFA/Basin and others addressed these legal issues in their Joint Petition For Reconsideration and nothing in these Comments should be construed in any way as waiving WFA/Basin’s challenge to the legal validity of this proceeding as it applies to the pending Western Fuels case.

Notice at 7.

WFA/Basin also presented substantial evidence demonstrating that its RAM method provided a reasonable alternative to percent reduction that prevented carrier rate manipulation in a manner that conformed to the Coal Rate Guidelines. WFA/Basin also demonstrated that its Reduced Mark-Up method was a superior alternative to percent reduction.

In the Notice, the Board proposes two other alternatives to percent reduction: the Maximum Contribution Method ("MCM") and the Maximum Mark-Up Methodology ("MMM"). MCM and MMM are new methodologies. The RAM and Reduced Mark-Up procedures are superior to MCM and MMM, and the RAM or Reduced Mark-Up procedures should be applied in the Western Fuels case. If the Board disagrees, and the choice becomes one of applying percent reduction or MCM/MMM, WFA/Basin believe either procedure is superior to percent reduction and could be fairly applied in Western Fuels (assuming as discussed below, they are used with MSP divisions). The evidence needed to apply the methods exists in the Western Fuels case record and, as Coal Shippers discuss in their Comments, both methods appear to be improvements on percent reduction in that they attempt to reduce the defendant carrier's ability to manipulate the outcome of SAC cases.¹⁸

¹⁸ If the Board asks for post-rulemaking supplemental evidence in Western Fuels, on rate relief methodologies, the Board should permit WFA/Basin to select the relief
(continued...)

- SAC Analysis Period. The Notice seeks comments on whether the SAC analysis (DCF) period should be shortened from 20 to 10 years. However, the Notice states that the Board does not propose to shorten the SAC analysis period in Western Fuels and AEP Texas because the records in these cases have been developed “based on a SARR designed to handle peak demand in a 20-year analysis period” and that shortening the analysis period to 10 years “could require the submission of an essentially new SAC case.” Id. at 2.

WFA/Basin concur with the Board that, regardless of whether the Board decides to shorten the SAC analysis period from 20 to 10 years in rate future cases where a record has not yet been developed, it would be inappropriate and inequitable to shorten the DCF period in their rate case. WFA/Basin configured the LRR in accordance with then-governing precedent. In all SAC cases decided in the past decade, the Board has approved the use of a 20-year DCF period. WFA/Basin adhered to this precedent. The LRR’s revenues, system configuration (and construction costs), operating plan and operating expenses were all developed by WFA/Basin on the basis of the traffic moving in the peak volume year of its operations, which is the 20th year of the SAC analysis period, and the peak volume week in that year in terms of train frequency. WFA/Basin would indeed have to start over with a new SAC presentation if the DCF period were

¹⁸(...continued)
methodology of their choice (as applied to existing record evidence) and defend that selection in the ensuing proceedings.

shortened to 10 years, as the peak volume year would change as would the peak week and associated train frequencies.

- Cross-Over Divisions. The Board proposes to substitute a new cross-over divisions procedure which it calls the Average Total Cost ("ATC") method. The ATC method should not be adopted for application to future cases for the reasons set forth in the Coal Shippers' Comments. However if the Board does adopt this method – which it should not – it would be manifestly inequitable to apply it to the pending Western Fuels case because, just as is the case in applying a 10-year DCF period, application of ATC would "require the submission of an essentially new SAC case." Notice at 2.

The Coal Rate Guidelines provide that a shipper has "broad flexibility to develop the least costly" SARR, to take advantage of "economies of density" and "maximize carriage of profitable traffic:"

The parties will have broad flexibility to develop the least costly, most efficient plant. The plant should be designed to minimize construction (or acquisition) and operating costs and/or maximize the carriage of profitable traffic. In selecting the route of a SAC railroad, for instance, an overriding factor may be the effort to lower costs by taking advantage of economies of density. Generally, a stand-alone railroad would attempt to fully utilize plant capacity, adding other profitable traffic in order to reduce the average cost of operation. Thus, the stand alone railroad may not represent the shortest route for the captive shipper, but the

one with the highest traffic densities. The factors to be considered depend upon individual circumstances. Hence, the optimal size and placement of the physical plant must be determined on a case-by-case basis.

Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 543-44 (1985).

WFA/Basin modeled the LRR in accordance with these principles as they had been applied by the Board in prior cases. At the time WFA/Basin constructed the LRR, the MSP/MMP divisions approach had been used in the last nine SAC cases. WFA/Basin relied on this approach as a central building block in determining the LRR's configuration. Specifically, the LRR – like any real world railroad or business – must project its revenues to determine how it will be configured in the marketplace. WFA/Basin projected the profitability of the LRR's coal traffic using the MSP method to forecast LRR on-SARR divisions. WFA/Basin proceeded to defend its use of MSP against the same attacks BNSF raised, and lost, in Otter Tail.

The Board now proposes to retroactively change a key building block WFA/Basin used to model the LRR – the MSP method – to a new divisions methodology – the ATC method. ATC is a significantly different divisions procedure than MSP, since it, among other things, eliminates the MSP origin and destination revenue blocks and does not allocate the remaining revenues on a straight mileage prorate.

These differences will have a huge significance, in some cases, on how a shipper will configure, as it is entitled to do under the Guidelines, a “least cost” SARR

that carries the “most profitable traffic.” By changing the divisions methodology, the Board changes the universe of “most profitable traffic,” and changes the analysis of how a SARR would be configured to maximize revenues on profitable traffic and minimize costs.

For example, if the ATC method had been in existence when the WFA/Basin was developing the LRR in the Winter of 2005, WFA/Basin would have most likely configured a SARR that was significantly longer and carried significantly more tons. WFA/Basin would then be defending this “ATC” SARR in subsequent proceedings before the Board, not the LRR.

WFA/Basin reasonably relied on MSP as a fundamental building block in configuring its SARR – the method the Board used for years to determine SARR divisions. If the Board decides to adopt ATC in this proceeding – which WFA/Basin and Coal Shippers urge the Board not to do – it would be unfair and inequitable to apply this new procedure in the pending Western Fuels case (a case involving a SARR designed using a different divisions methodology) because it “would require the submission of a new SAC case.”

Also, BNSF did not present density-based divisions evidence in Western Fuels on grounds that the Board had repeatedly rejected density-based division

methodologies in prior cases.¹⁹ Nor does the record include the essential SAC information or data WFA/Basin needs to properly develop an ATC SARR. Thus, in order to properly apply ATC in Western Fuels, the parties would need to go back to square one – the discovery process. Reopening discovery in the Western Fuels case more than two years after the case was filed, and more than one-year after the record closed, is also fundamentally unfair and inequitable.

- Indexing Operating Costs. In the Western Fuels case, WFA/Basin urged the Board to forecast the LRR operating costs using the 0.59 RCAF-U index. The Board has proposed a different indexing procedure that phases in SARR productivity gains over a twenty-year period. The Coal Shippers' Comments, as well as the Western Fuels case-specific evidence appended hereto, demonstrate that the Board's proposal – while a step in the right direction – understates SARR productivity gains in general, and LRR productivity gains, in particular.

While application of the Board's proposal clearly can be accomplished on the existing record in the Western Fuels case, and any application of the Board's proposal is better than applying no productivity adjustment in forecasting LRR operating expenses, it would be incorrect for the Board to apply its proposal in Western Fuels because the Board's proposal understates LRR productivity gains. WFA/Basin urge the Board to

¹⁹ See Western Fuels, BNSF Reply Narr. at I-10 (filed July 20, 2005) (public version).

modify its proposal by adopting either the 0.59 RCAF-U index, or the Coal Shippers' proposal, for application in its rate case because either procedure produces a better forecast of LRR productivity adjusted operating expenses than the Board's proposal.

- Variable Costs. The Coal Shippers urge the Board to continue to use properly adjusted URCS costs in calculating the jurisdictional threshold. WFA/Basin agree. In the Western Fuels case, the properly developed adjusted system average costs are those that WFA/Basin has tendered to the Board. WFA/Basin request that the Board adopt their variable cost calculations, as developed in the record in Western Fuels, for the reasons set forth in WFA/Basin's filings in Western Fuels.

- Supplemental Evidence. The Board can decide the Western Fuels case on the record currently presented. It does not need a rulemaking proceeding to fairly address and resolve all pending issues in that case as it would in any other adjudication. In so doing, the Board is free to adopt WFA/Basin's evidence – evidence which is clearly the best evidence of record – or otherwise exercise its informed discretion to resolve issues presented.

However, the Board has chosen a different path, by instituting this proceeding, and by proposing that the parties in Western Fuels submit "supplemental evidence" at the conclusion of this proceeding. Notice at 3. WFA/Basin request that the Board limit any post-rulemaking "supplemental evidence" to simple, prompt submissions

that conform to WFA/Basin's and Coal Shipper's Comments. Any other procedure would be manifestly unfair to WFA/Basin.

Respectfully Submitted,

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Dated: May 1, 2006

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CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of May, 2006, I caused a copy of the foregoing Additional Opening Comments to be served by hand delivery on counsel for BNSF, as follows:

Samuel M. Sipe, Jr.
Anthony J. LaRocca
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I also caused copies of these Additional Opening Comments to be served by U.S. First Class mail on all other parties on the Board's Ex Parte No. 657 (Sub-No. 1) service list as well as on the parties to the other dockets that have been joined in this proceeding.

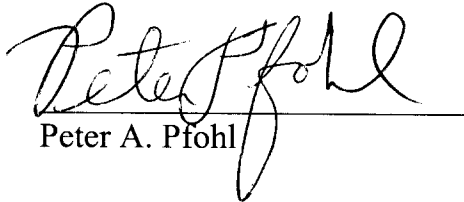

Peter A. Pfohl

EXHIBIT 1A

WFA/BASIN'S OPENING EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

**PERCENT REDUCTION AND OTHER METHODS
FOR ALLOCATING SAC RATE RELIEF**

As shown in Table III-H-1, the present value of the LRR's expected revenues exceeds the present value of the LRR's costs by approximately \$1552.0 million.

3. LRR SAC Rates

The Guidelines do not set forth a specific method for determining movement-specific SAC rates. Xcel I at 36. Instead the Guidelines "leave[] this inquiry to a case-by-case analysis." Id. WFA/Basin calculate LRS SAC movement-specific rates using the reasonable allocation method ("RAM"). WFA/Basin respectfully request the Board to utilize RAM for reasons discussed below.

a. Problems With The Application Of The Percentage Reduction Method In This Case

In its recent coal rate decisions, the STB has used the percentage reduction method to calculate movement-specific SARR rates. The percentage reduction method calls for the STB to reduce the total revenues for the SAC traffic group by a uniform percentage so that the SAC revenues, as reduced, equal SAC costs. Applying the percentage reduction approach produces the SAC rates shown in Exhibit III-H-2 for the LRS movements.⁷ As shown in Exhibit III-H-2 the starting point for rate relief is the BNSF's initial common carrier tariff rates. The problems with this approach are self-evident.

First, the percentage reduction method in effect transfers the power to set maximum rail rates from the Board to market dominant rail carriers. This transfer is

⁷ See also electronic workpaper file "Exhibit_III-H-1R.xls." If the Board decides to continue to use its current percent reduction approach in this case, the Board should prescribe maximum LRR SAC rates at the levels shown in Exhibit III-H-2.

accomplished because, under governing law, rail carriers – not the STB – have the power to initially establish rail rates⁸ and, under the percentage reduction method, where the initial rates are set dictates the resulting maximum rates.

Table III-H-2 illustrates this point. In Table III-H-2, WFA/Basin ran the LRR DCF model assuming different, hypothetical 4Q04 LRS rates that apply from all origin groups.

Table III-H-2 Hypothetical Percentage Reduction LRS SAC Rates Using Different 4Q04 Starting Rates		
Starting LRS Rate (\$/ton)	% Reduction ⁹	LRS 4Q04 SAC Rate
\$ 9.00	44.30	\$5.01
\$ 8.00	42.81	4.58
\$ 7.00	41.23	4.11
\$ 6.00	39.57	3.63
\$ 5.00	37.81	3.11
\$ 4.00	35.94	2.56

⁸ See 49 U.S.C. §10701(c) (carrier initiates common carrier rates).

⁹ The percentage reduction changes slightly due to the revenue impact of the involved LRS rates in the DCF analysis. One of the reasons that a railroad has such a large incentive to set an artificially high common carrier rate for purposes of an anticipated maximum rate case is that the portion of the over-recovery of revenues for the stand-alone railroad that is allocated under the percentage reduction methodology to other traffic has no effect on the railroad's revenues. Thus, the railroad knows that where the stand-alone railroad is likely to involve substantial volumes of other traffic, the great majority of the excess revenues over stand-alone cost will be offset against the other traffic. For example, here, where LRS's traffic constitutes 15.6% of the 2005 stand-alone traffic group revenue, for every \$1.00 of excess revenue reduced through the percentage reduction methodology, 84 cents will be allocated to fictional rate reductions against non-issue traffic and only 16 cents will have any actual impact on the railroad's revenues.

As illustrated in Table III-H-2, the maximum SAC rates under the percentage reduction method are driven principally by the starting rates. These results subvert Congressional intent. Congress has directed the Board to determine whether rates on market dominant rail traffic are “reasonable.” 49 U.S.C. §10701(d)(1). The statutory directive requires that the Board engage in “meaningful rate regulation.”¹⁰ As one of the nation’s leading transportation economists, Dr. Curtis Grimm, observes, there is no meaningful rate regulation if the regulated entity – not the regulator – controls the regulatory answer.

Second, the percentage reduction approach provides an open regulatory invitation from the Board to the railroad industry to set whatever rates the industry wants on captive coal traffic. This phenomenon has been described in recent cases as “gaming” the system.¹¹ However, rail carriers do not need to “game” the percentage reduction method. The method itself is the “game.” Regardless of the subjective intent of the carrier, i.e. a deliberate effort to hit a target number or some other motivation, the result is the same – whatever rate the carrier sets (high, low or in between) dictates the regulatory answer.

Third, there can be little doubt that BNSF has decided to exploit the percentage reduction process to obtain higher and higher coal rates – all with the blessing of the STB under the percentage reduction method. This forced march to higher and higher rail rates is readily observed in the STB’s recent PRB coal rate case dockets. As

¹⁰ Farmers Union Cent. Exch. Inc. v. FERC, 737 F.2d 1486, 1507 (D.C. Cir. 1984).

¹¹ See, e.g., CPL at 32.

shown in Table III-H-3 below, progressively higher challenged common carrier rates have inevitably led to higher percentage reduction answers.

Table III-H-3 Recent STB PRB Coal Case Results		
Case/Year Decided	Representative Base Common Carrier Rate Challenged (Mills and R/VC Ratio)	Corresponding SAC Rate Under % Reduction (Mills and R/VC Ratio)
WPL/UP – 2002	11.5/193%	9.8/165%
TMPA/BNSF – 2003	13.5/199%	13.1/193%
Xcel/BNSF – 2004	24.2/302%	20.2/252%

Fourth, BNSF – no doubt emboldened by the Board’s recent coal rate decisions – has evidently decided to floor the percentage reduction accelerator in this case. BNSF’s 4Q04 rates (with surcharge) exceed 38 mills and produce R/VC ratios well in excess of 481%. Unfortunately, BNSF’s pricing actions are encouraged by the percentage reduction method – the method where rate regulation for all practical purposes simply does not exist.

b. The Fair Alternative – RAM

To its credit, the STB has recognized the obvious problems with its percentage reduction method. As the Board held in CPL: “the maximum reasonable rate that can be charged to a complaining shipper should be determined by the Board, not by parties’ litigation tactics.” Id. at 32. The Board has also invited complainant shippers to present alternatives to the percentage reduction methodology in new cases. Id. at 33

(“[t]he Board welcomes proposals for appropriate alternatives to the percentage reduction approach in future cases”); Xcel I at 37 (same).

The Board had instructed shippers that the alternatives presented must conform to the Coal Rate Guidelines pricing directives;¹² and “remove the flaws” in the percentage reduction methodology.¹³ RAM meets both tests.

**i. The RAM Procedure
For Allocating SAC Costs**

The RAM procedure is simple and straight-forward and consists of the following steps:¹⁴

- Step 1 – Calculate LRR Variable Costs.
The first RAM step calculates LRR’s variable costs for providing service to each LRR traffic group member. WFA/Basin use LRR-specific URCS unit costs to make these calculations.¹⁵
- Step 2 – Calculate LRR Unattributable Costs.
The second RAM step calculates the LRR’s unattributable costs. The unattributable costs equal the sum of total SAC costs (SAC operating expenses plus SAC road property capital requirements) minus total LRR variable costs calculated under Step 1, above.¹⁶

¹² CPL at 32.

¹³ CPL at 32, Xcel I at 38.

¹⁴ See electronic workpaper file “LRS RAM Rates 4Q 2004-2024.xls”.

¹⁵ See electronic workpaper file “LRR Service Units.xls.” The procedures WFA/Basin use to calculate LRR movement-specific costs are also summarized in Exhibit III-H-3.

¹⁶ See electronic workpaper file “LRS RAM Rates 4Q 2004-2024.xls.”

- Step 3 – Division of Traffic Group. The third step in RAM is to divide the LRR traffic group into two groups: the captive coal shipper group and the competitive coal shipper group. The captive group consists of coal shippers that are captive to the BNSF at the traffic destination or at origin by virtue of a long-term coal supply contract. The competitive group consists of coal shippers that enjoy competition (i.e., at least two different carrier sets between origin and destination) and shippers where the BNSF competes with UP to provide service to an interchange or barge transfer point for movement beyond to a utility destination that is sole-served by a rail carrier other than BNSF or UP or is served by water carrier.¹⁷

- Step 4 – Allocate Unattributable Costs. The fourth RAM step allocates unattributable costs only to the LRR's captive shippers under a prorate approach. The competitive coal shippers make no contribution.¹⁸

- Step 5 – LRR Shipper Rates. The final RAM step calculates LRR shipper SAC rates. These rates equal the LRR shipper-specific variable costs calculated under Step 1 plus shipper-specific allocation of unattributable cost calculated under step 4.¹⁹

Application of the RAM procedure produces SAC rates for the LRS traffic shown in Table III-H-4.²⁰

¹⁷ See electronic workpaper file "LRR 2004 to 2024 Stats.xls." The captive O/D pairs are listed in Exhibit III-H-4.

¹⁸ See electronic workpaper file "LRS RAM Rates 4Q 2004-2024.xls."

¹⁹ See electronic workpaper file "LRS RAM Rates 4Q 2004-2024.xls."

²⁰ See electronic workpaper file "LRS RAM Rates 4Q 2004-2024.xls."

Table III-H-4 LRS SAC Rates Using RAM	
Period	SAC Rates
4Q04	\$ 3.38
2005	3.05
2006	3.00
2007	2.94
2008	2.98
2009	2.84
2010	2.88
2011	2.92
2012	2.96
2013	3.01
2014	3.07
2015	3.11
2016	3.16
2017	3.21
2018	3.26
2019	3.29
2020	3.35
2021	3.40
2022	3.46
2023	3.50
1Q-3Q2024	3.53

ii. **The Applicable Coal Rate
Guidelines Standards**

RAM fully complies with the Coal Rate Guidelines. Before making this demonstration, it is useful to review the pertinent Guidelines principles concerning the calculation of shipper-specific SAC rates.

The Coal Rate Guidelines were issued in the summer of 1985. At that time the ICC had a tremendous backlog of coal rate cases. Many of these cases had been in limbo for years while the Guidelines were being formulated. As consequence of the backlogged docket, the ICC needed not only a set of defensible ratemaking standards that could withstand judicial review, it also needed ones that could be implemented practically in pending cases to produce fair results.

One consequential issue the ICC knew it had to address in the Guidelines was how to calculate shipper-specific SAC rates. Without this discussion, the Guidelines would not have been of much use in solving the ICC's underlying problem – deciding pending coal rate cases.

In its Guidelines decision, the ICC called for calculation of shipper-specific SAC rates “on the basis of Ramsey [Pricing] principles.” Id. at 546. These principles allocate unattributable SAC costs to traffic group members “in inverse proportion to demand elasticities.” Id. at 554. The ICC was fully aware, however, that translating Ramsey Pricing into case-specific rate relief was an impossible proposition. As stated by the ICC:

We did not consider it to be practical to impose pure Ramsey pricing as a regulatory requirement for across-the-board application in all cases. Ramsey pricing is based on a mathematical formula which requires both the marginal cost and the elasticity of demand to be quantified for every movement in the carrier's system. Thus, the amount of data and degree of analysis required seemed overwhelming. We concluded that while formal Ramsey pricing is useful as a theoretical guideline, it is too difficult and burdensome for universal application.

Id. at 527 (footnote omitted). Of course, impossible propositions did not solve the ICC's pending case crunch.

The ICC addressed and resolved this issue by suggesting a practical answer – shippers could evenly allocate SARR costs to SARR traffic group members that shared “similar demand elasticities.” Thus the Guidelines provide:

We will consider evidence that particular [SARR] shippers face similar market conditions and therefore have similar demand elasticity.

Id. at 533. The ICC also held that shippers could present practical, qualitative evidence to demonstrate these similar demand elasticities:

[w]here information on demand elasticity is required ... we will consider qualitative (rather than necessarily quantitative) evidence on the relative demand elasticity of specific movements and/or commodities.

Id. at 527.

The ICC's solution found support in the filings made by a large group of western railroads (“Western Railroads”) that included BNSF's predecessors. In their

comments, the Western Railroads urged the ICC to set shipper specific SAC rates by allocating a “pro-rata sharing of costs” to “movements of the same commodity – or at the very most, commodities the transportation of which (if not identical) is characterized by similar elasticity of demand.”²¹

The ICC proceeded to apply these elasticity principles in the landmark OPPD case. OPPD was the first coal rate case decided under the new Guidelines. Like many other coal rate cases, OPPD had been languishing for years as the ICC formulated the Guidelines. In OPPD, the complainant shipper (“OPPD”) devised a SARR that extended from the Wyoming PRB to OPPD’s coal-fired generating plant in Arbor, Nebraska. The “vast preponderance” of OPPD’s SARR traffic was coal traffic. Id. at 136 n.21. Some non-coal traffic was included as well.

In OPPD, the ICC found the SARR revenues exceeded the SARR costs. As a consequence, the ICC calculated a SARR-specific maximum rate for OPPD. The ICC’s calculations required all SARR traffic group members to pay their variable costs. The remaining unattributable costs (total SARR cost minus traffic variable costs) “were divided among unit-train coal shippers, pro rata, on the basis of usage.” Id. at 136.

The ICC found this approach entirely consistent with its recently issued Guidelines. The ICC first observed that the Guidelines expressly permit the use of qualitative evidence to determine SARR group members demand elasticities. The ICC

²¹ Comments of Western Railroads, ICC Ex Parte No. 347 (Sub. No. 1) at 75 (filed July 28, 1983) (emphasis in the original), excerpted in Workpapers Vol. 11, pp. 6447-6451.

decision stated in pertinent part:

In the Final Guidelines, we indicated that, ideally, unattributable cost should be divided among the members of the stand-alone group on the basis of demand. We added, however, that the issue was best left to a case-by-case evaluation because there are practical problems surrounding the estimation of elasticities. Because of the potential difficulty of precise quantification of demand elasticities, Final Guidelines indicated that “qualitative” evidence of relative demand would be sufficient.

Id. at 139 (footnotes omitted).

The ICC next found that the OPPD SARR coal shippers shared similar demand elasticities. The ICC rested this conclusion on qualitative facts – each SARR coal shipper tendered the same commodity (bituminous coal), from the same general origin area (the PRB), in similar transportation service (unit trains), to similar destinations (utility coal-fired electric generating plants):

As noted, Omaha Power distributed all unattributable costs of [the SARR] system uniformly over all unit-train coal shipments, the hypothesis being that the strength of demand for each coal shipper is sufficiently similar to recover an average contribution. The qualitative evidence for OPPD’s methodological short-cut is derived principally from the fact of similarity among members of the group. The grouping consists of the same commodity, shipped from the same general origin, with similar unit-train service characteristics, destined for the same end use (consumption in domestic electric utility plants).

Id. at 139-40.

Finally, the ICC emphasized that its pro-rata distribution of unattributable costs to the SARR coal shippers fully complied with the Guidelines.

In deciding this issue ... we do not withdraw from the principle that allocation of unattributable costs among captive shippers is based ideally on relative demand elasticities. Indeed, complainant has not asked for repudiation of this principle. In complainant's view,

* * * the issue comes down to the extend to which it is feasible, *given the facts in each contested proceeding*, to make groupings of shipments with reasonably comparable elasticities of demand * * * without jeopardizing the ability of the railroad to recover its aggregate stand-alone costs.

We agree with this formulation....

Id. at 140 (emphasis in original).

The ICC applied similar procedures in the next major PRB coal rate case it decided – the APL case. That case, like the OPPD case, was a PRB coal rate case. In APL, the shipper (Arkansas Power & Light) challenged, *inter alia*, BNSF coal rates from the PRB to its Redfield, Arkansas coal-fired generating facility. In APL, the ICC found the coal shippers in the SARR traffic group had similar demand elasticities and, therefore, allocating a pro-rata share of unattributable SARR costs to each such shipper was permissible under the Guidelines. The ICC's decision states in pertinent part:

We find that in this case [Arkansas Power & Light's] assumption regarding the like elasticity for its group is reasonable and we accept it. As in *Omaha*, the non-issue traffic consists of the same commodity (coal), with similar service characteristics (unit-train service), destined for the same end use

(consumption in electric utility plants), and shipped from the same general origin (Powder River Basin). On this record, we are satisfied that any degree of variation in the demand elasticities of the non-issue shippers is not significant and therefore each shipper can reasonably be assigned an equal portion of the non-attributable costs of the stand-alone system.

Id. at 774. After APL, the STB eventually turned to use of the percentage reduction method to calculate movement-specific SARR costs.

iii. RAM Complies With The Governing Guidelines Standards

The Guidelines as written, and as initially applied in OPPD and APL, permit a pro-rata sharing of unattributable costs amongst SARR traffic group members that share generally similar elasticities of demand. Each RAM step complies with these standards.

- Step 1 – Calculate LRR Variable Costs. In OPPD and APL, all SARR shippers paid their variable costs. The same holds true under RAM. RAM also improves the accuracy of the SARR variable cost calculation by calculating LRR-specific URCS unit costs, rather than using the defendant carrier's unit costs (as was done in OPPD and APL). LRR-specific URCS unit costs more accurately reflect the LRR's costs.

- Step 2 – Unattributable Cost Calculations. The Guidelines provide that “[t]he long run marginal cost (LRMC) is the economic measure of the long-term attributable cost of each service.” Id. at 537-38. The Board has long-used “variable costs produced by the URCS formula as proxy for LRMC” and considered “[t]he remaining

(nonvariable) portions ... as a proxy for unattributable costs.” Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1027-28 (1996).

RAM follows procedures the ICC approved in the Guidelines, and applied in OPPD and APL, to calculate unattributable costs.²² These costs equal total SARR costs minus SARR variable costs calculated using the Board’s URCS costing procedures.

- Step 3 – Division of Traffic Group. In OPPD and APL, the complainant shipper divided its traffic group into two segments: captive coal shippers and others. The third RAM step does the same. Via the third step, RAM customers (all of whom are coal shippers) are divided into two categories: captive shippers and competitive shippers. Under RAM, captive shippers consist of coal shippers that are captive to LRS/BNSF because BNSF is the sole delivering rail carrier to the shipper’s plant or, in one instance, because the shipper will be captive to LRS at origin due to a long-term coal supply contract. As shown in Exhibit III-H-4, the LRR traffic group contains 30 captive shipper plants. The captive shipper plants are also displayed in Table III-H-5:

²² See OPPD at 139; APL at 774.

[illegible]

In OPPD and APL, the complainant shippers relied upon qualitative evidence to demonstrate that each captive coal shipper in its SARR had reasonably similar demand elasticities. Here, several interrelated facts demonstrate the members of LRR captive shipper group have reasonably similar demand elasticities for SAC revenue allocation purposes.

- As shown in the electronic workpapers, all of the LRR captive shippers are utility shippers of bituminous coal.²³ Bituminous coal is only one commodity among the thousands of individual commodities named in the Standard Transportation Commodity Code. Thus, WFA/Basin start out with a very tiny defined traffic group that represents, from a commodity perspective, 0.003% of the total universe of commodities carried by rail.²⁴
- As shown in the electronic workpapers,²⁵ each LRR captive shipper originates its bituminous coal deliveries from the same producing area (the PRB), each LRR captive shipper has the coal transported in the same form of service (unit train service), and each LRR captive shipper's coal is delivered to similar destinations (utility coal-fired power plants).

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²⁴ According to the AAR, railroads carry 32,716 different commodities. Phone conversation with AAR Economics, Policy and Statistics Department, April 14, 2005.

²⁵ See electronic workpaper file "LRR Traffic and Revenues_WFABasin Opening.xls."

- As referenced in Exhibit III-H-4, each LRR captive shipper is sole-served by BNSF or LRS. The Board has consistently acknowledged the substantial market power that a railroad has over pricing to its sole-served utility coal customers.²⁶ Similarly, the Board's predecessor, the ICC observed: "long-haul, large-volume, heavy-loading traffic such as coal is likely to be captive to rail, and hence have a relatively low demand elasticity."²⁷

- As shown in Exhibit III-H-5, the LRR captive coal traffic is delivered to base-load coal-fired facilities.²⁸ Base-load plants are typically must-run plants a utility needs to operate to meet its native load.²⁹ Railroad pricing power is at its highest – and shipper price elasticity is at its lowest – for coal transportation to captive base-load plants.³⁰

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²⁶ See TMPA at 11; WTU at 648-52; APS I at 374-79.

²⁷ Coal Rate Guidelines – Nationwide, 364 I.C.C. at 360, 365 (1980).

²⁸ Base load plants are defined as having a "nominal annual capacity factor of 65%." APS I at 377 n.24. {

²⁹ See WTU, 1 S.T.B. at 653.

³⁰ Id., at 652-654; APS I at 377-78; APS II at 72-74.

³¹ See Reply Evidence of The Burlington Northern and Santa Fe Railway Company in Docket No. 41191 (Sub No. 1), AEP Texas v. BNSF, Public Version at III-A-99, and Reply Evidence of The Burlington Northern and Santa Fe Railway Company in Docket No. 42071, Otter Tail Power v. BNSF, Public Version at III-A-111 to III-A-112.

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³² See Workpapers Vol. 11, pp. 6239-6247; electronic workpaper file folder "Kraemer Rate Study from BNSF's Reply in AEP Texas."

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- Step 4 – Allocate Unattributable Costs. Consistent with the ICC's approach in OPPD and APL, WFA/Basin allocate all unattributable costs (i.e., total SAC costs minus each LRR shipper's variable costs) to each SARR captive shipper on a prorata basis.³⁴ Also, consistent with OPPD and APL, competitive SAC shippers make no contribution to the LRR's unattributable costs.

- Step 5 – LRR Shipper Rates. The LRR shipper SAC rates under RAM are calculated for the LRR traffic in the same fashion as the ICC calculated SAC rates in APL and OPPD. These rates equal the LRS variable costs plus a pro rata allocation of unattributable costs.

³³ Coal Rate Guidelines, Nationwide, Ex Parte No. 347 (Sub. No. 1)(ICC served Feb. 24, 1983) at 5 n.13.

³⁴ For movements where variable costs plus allocated unattributable costs produced revenue greater than the movement's SAC revenue, the allocated SAC was set at the movement's revenue, and the excess unattributable costs were reallocated to the remaining captive movements.

**iv. Use of RAM Removes The Flaws
In The Percentage Reduction Method**

RAM removes the overarching flaw in the percentage reduction approach: under RAM, the maximum rate is not determined using the defendant carrier's starting rate. RAM returns the power to set maximum rates to the Board under a fair, reasonable, and precedent-supported application of the Guidelines. RAM also eliminates several subsidiary flaws in the percentage reduction approach.

- Undermining Contracts. In promulgating the Coal Rate Guidelines, the ICC had hoped to provide a set of procedures that shippers and carriers could use to negotiate contracts. See, e.g., Guidelines, at 524 ("a benefit of these guidelines is to enable both the shipper and the railroad to estimate the maximum rate we would prescribe if the matter were brought to us for adjudication"). The ICC also stated that "we will be careful in applying these guidelines to avoid inhibiting or discouraging contract solutions." Id.

The percentage reduction approach defeats contract solutions because the carrier controls the answer with its starting rate. Carriers have no incentive to negotiate when they control the regulatory answer. Also, a shipper cannot reasonably determine what the SAC answer will be under percentage reduction unless and until it first obtains the carrier's proposed rate. However, the law does not require a carrier to provide a proposed rate until shortly before the service commences.³⁵ When a carrier exercises its

³⁵ See FMC Wyoming Corp. v. Union Pacific R.R., Docket No. 33467 (STB served Dec. 16, 1997) at 3 and n.7; Burlington Northern R.R. v. STB, 75 F.3d 685 (1996).

legal prerogative, shippers cannot estimate maximum SAC rates in time for meaningful contract negotiations.

RAM solves these problems. Under RAM, the carrier no longer controls the maximum rate process. RAM also levels the negotiating playing field by allowing shipper and carrier to make a reasonable SAC rate calculation from a common set of data points. Thus, RAM, unlike percentage reduction, promotes reasonable contract solutions.

- SAC Theory Conflicts. The percentage reduction approach also lacks solid theoretical underpinnings in the Guidelines. The Guidelines never discuss the “percentage reduction” method. Nor was the method applied in the first set of post-Guidelines coal rate cases. Percentage reduction came later.

The theory behind percentage reduction is that it “preserve[s]” the defendant carrier’s rate structure.³⁶ As described by the STB in Xcel I:

The rationale for applying this percentage reduction method was to preserve the rate structure for the traffic group by maintaining existing rate relationships, albeit at reduced levels, thereby implicitly preserving the carrier’s demand-based differential pricing that recognizes the traffic’s varying demand elasticities.

Id. However, preserving a defendant carrier’s existing pricing structure is flatly inconsistent with the Guidelines. The Guidelines permit a shipper to design a more

³⁶ Xcel I at 37.

efficient low cost “alternat[ive]” to the existing railroad. Id. at 524.³⁷ If that railroad is viable – i.e., if its revenues exceed its costs – the railroad is by definition something that no defendant railroad is today – revenue adequate under the Board’s revenue adequacy standards. The SARR’s revenue adequacy comes about because the SARR is earning a current cost of capital return on its net investment. Id. at 535.

The Guidelines teach that where a carrier is revenue adequate, the carrier’s rate structure must change to reflect the need for less contribution from captive traffic.

As stated in the Guidelines:

captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of the differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs.

Id. at 535-36.

The percentage reduction method mistakenly superimposes a differential pricing regime used by a revenue-inadequate defendant carrier onto a revenue-adequate SARR. RAM corrects this error. RAM provides a fair and logical pricing structure where captive traffic group members with similar demand elasticities are allocated a pro-rata share of the SARR’s unattributable costs, which costs are capped at the revenue level needed by the SARR to achieve revenue adequacy.

³⁷ Similarly the Guidelines provide that “[t]he SAC test offers a procedure for separating costs and treating them on the basis of identifiable subsystems, rather than on a firm-wide basis.” Id. at 539 n.47.

- Improper Reliance on Price As A Surrogate For Demand Elasticity.

Finally, in many cases the price a shipper pays is a poor surrogate for its demand elasticity. The instant case is living proof. Here, BNSF more than doubled the LRS rates with the stroke of its ratemaking pencil. The inelasticity of the LRS demand did not double at the same time, however.

WFA/Basin Witness Weishaar, who was CNW/WRPI's chief coal pricing officer for many years, reports that in pricing captive coal movements, WRPI and UP (its only connecting carrier) did not attempt to charge demand-based "what the traffic will bear" rates on captive PRB coal traffic. Instead, the carriers would focus on other matters including regulatory factors such as the maximum rate levels being prescribed by the ICC/STB in coal rate cases. Mr. Weishaar left CNW/WRPI in 1995, but has followed subsequent railroad coal marketing and pricing practices as a consultant. He observes that through the Board's WPL I decision in 2002, it was generally understood within the rail industry that the ICC/STB would set rates in the 180% R/VC range on captive PRB traffic moving over dense PRB traffic corridors. Mr. Weishaar also observes that this understanding no longer applies after recent Board decisions, including Xcel I and Xcel II, wherein the Board approved substantially higher PRB coal rates. These increases are not driven by any changes in the "demand elasticity" for the involved coal traffic. Instead, the rates are going up because the STB, through applications of the SAC/percentage reduction standard, is approving much higher rates.

RAM solves the price-as-a-surrogate-for-demand elasticity by removing price as the sole criteria of demand elasticity. In so doing, RAM puts the regulatory focus

back where the Guidelines intended it to be – on a multi-factor qualitative analysis to identify shipper demand elasticities.

v. **RAM Produces Very
Conservative Results**

RAM produces very conservative results. For example, in 2005, the LRS traffic constitutes approximately 8% of the total LRR revenue ton-miles.³⁸ Under RAM, the LRS traffic pays over 29% of the LRR's unattributable costs.

RAM also produces higher rates for the LRS traffic than other Ramsey Pricing surrogates. For example, WFA/Basin have calculated LRS rates assuming that each shipper in the LRR traffic group's revenue contribution is reduced on a pro rata basis, i.e., the Reduced Mark-Up method. The revenue contribution under this approach equals each shipper's movement-specific revenues minus each shipper's movement-specific variable costs.³⁹ The pro rata reduction equals the percentage reduction needed to reduce each shipper's revenue contribution so that LRR stand-alone revenues equal LRR stand-alone costs. As summarized in Exhibit III-H-6, the resulting LRS rates are significantly below the LRS rates calculated using RAM.

³⁸ See electronic workbook file "LRS RAM Rates 4Q 2004-2024.xls."

³⁹ See electronic workbook file "LRR Ramsey Mark-up Reduction.xls." As the ICC explained in the Guidelines, "[u]nder Ramsey pricing, each price or rate contains a mark-up above the long-run marginal cost of the product or service to cover a portion of the unattributable costs." Id. at 526. WFA/Basin's calculations here produce movement-specific pro-rata reductions in the Ramsey mark-ups. This approach differs from the STB's percentage reduction method since it reduces the mark-up, not the rate. Also, reductions are capped so that they do not fall below the shipper's variable costs.

c. Other SAC Relief Quantifications

WFA/Basin use RAM to calculate the SAC rate relief. However, WFA/Basin have no objection to the Board setting the LRS rates using the Reduced Mark-Up method as calculated by WFA/Basin. This alternative is superior to the Board's percentage reduction method because it properly focuses on reducing revenue contribution, not rates, but, like percentage reduction, suffers from a common flaw: the relief is predicated on the defendant carrier's initial tariff rates.

Also, as noted above, if the Board decides to use the current percentage reduction method, WFA/Basin request that the percentage reduction be set at levels shown in Exhibit III-H-2.

WFA/Basin summarize the rate results under each approach (RAM, Reduced Mark-Up and Percentage Reduction) in Exhibit III-H-6.

4. Maximum Rates

a. 4Q04 Rates

The maximum rates for BNSF service to LRS equal the greater of the stand-alone cost or the jurisdictional threshold. Table III-H-6 compares BNSF's 4Q04 rate levels (Column 2) to the 4Q04 jurisdictional threshold calculation (Column 4) and the 4Q04 stand-alone costs (calculating using RAM) (Column 5).

Table III-H-6 Summary of Maximum Rate Calculations for Issue Traffic in 4Q04					
<u>Origin</u> (1)	<u>BNSF Rate With Surcharge Per Ton</u> (2)	<u>BNSF Variable Cost Per Ton</u> (3)	<u>Jurisdictional Threshold Per Ton</u> (4)	<u>Stand-Alone Cost Per Ton</u> (5)	<u>Maximum Rate Per Ton</u> (6)
Dry Fork	\$ 6.71	\$ 1.41	\$ 2.54	\$ 3.38	\$ 3.38
Eagle Butte	6.72	1.45	2.61	3.38	3.38
Cordero	6.48	1.26	2.27	3.38	3.38
Caballo Rojo	6.53	1.27	2.29	3.38	3.38
Jacobs Ranch	6.25	1.21	2.18	3.38	3.38

WFA/Basin ask the Board to prescribe the maximum rate shown in Column 6 of Table III-H-6.

b. 4Q04 Reparations

WFA/Basin have calculated the reparations they are due for overcharges incurred during 4Q04. This amount equals the difference between the freight charges BNSF collected and the maximum permitted, plus applicable interest. These amounts are calculated in Exhibit III-H-7 and equal \$6,416,213.44, exclusive of interest.

c. Post-4Q04 Rates and Reparations

WFA/Basin request the Board to prescribe SAC rates (using RAM) set forth in Table III-H-7 to apply starting in 1Q05 through 3Q2024.

EXHIBIT
III-H-1
REDACTED

SUMMARY OF PERCENTAGE
REDUCTION LRS RATES¹

Time Period	Common Carrier Rate ²	Percent Reduction	LRS SAC Rate
4Q 2004	\$ 6.04	39.64%	\$ 3.65
2005	6.17	41.42	3.62
2006	6.18	42.14	3.58
2007	6.27	42.72	3.59
2008	6.37	42.61	3.66
2009	6.52	43.51	3.68
2010	6.64	43.62	3.74
2011	6.79	43.83	3.81
2012	6.93	44.05	3.88
2013	7.09	44.24	3.95
2014	7.26	44.37	4.04
2015	7.43	44.65	4.11
2016	7.60	44.74	4.20
2017	7.78	44.88	4.29
2018	7.97	45.16	4.37
2019	8.16	45.90	4.41
2020	8.35	46.18	4.49
2021	8.54	46.50	4.57
2022	8.75	47.02	4.63
2023	8.95	47.79	4.67
1Q-3Q 2024	9.16	48.62	4.71
¹ Source: electronic workpaper file "Exhibit _III-H-1R.xls."			
² The common carrier rate is calculated using the adjustment procedures described in Part III-A-3-a.			

EXHIBIT
III-H-3
REDACTED

EXHIBIT
III-H-4
REDACTED

EXHIBIT
III-H-5
REDACTED

**Summary of LRS Average Rates Calculated Using The RAM,
Percent Reduction and Reduced-Markup Methods
4Q 2004 - 1st 9 Months 2024**

	<u>Period</u> (1)	<u>Common Carrier Rate Per Ton 1/</u> (2)	<u>LRS Rates Per Ton Calculated Using:</u>		
			<u>Percent Reduction 2/</u> (3)	<u>RAM 3/</u> (4)	<u>Reduced Mark-Up 4/</u> (5)
1.	4Q 2004	\$6.04	\$3.65	\$3.38	\$2.80
2.	2005	\$6.17	\$3.61	\$3.05	\$2.59
3.	2006	\$6.18	\$3.58	\$3.00	\$2.56
4.	2007	\$6.27	\$3.59	\$2.94	\$2.55
5.	2008	\$6.37	\$3.66	\$2.98	\$2.60
6.	2009	\$6.52	\$3.68	\$2.84	\$2.59
7.	2010	\$6.64	\$3.74	\$2.88	\$2.63
8.	2011	\$6.79	\$3.81	\$2.92	\$2.68
9.	2012	\$6.93	\$3.88	\$2.96	\$2.72
10.	2013	\$7.09	\$3.95	\$3.01	\$2.77
11.	2014	\$7.26	\$4.04	\$3.07	\$2.83
12.	2015	\$7.43	\$4.11	\$3.11	\$2.87
13.	2016	\$7.60	\$4.20	\$3.16	\$2.94
14.	2017	\$7.78	\$4.29	\$3.21	\$2.99
15.	2018	\$7.97	\$4.37	\$3.26	\$3.04
16.	2019	\$8.16	\$4.41	\$3.29	\$3.07
17.	2020	\$8.35	\$4.49	\$3.35	\$3.12
18.	2021	\$8.54	\$4.57	\$3.40	\$3.17
19.	2022	\$8.75	\$4.63	\$3.46	\$3.21
20.	2023	\$8.95	\$4.67	\$3.50	\$3.24
21.	9 mos 2004	\$9.16	\$4.71	\$3.53	\$3.26

1/ The common carrier rate is calculated using the adjustment procedures described in Part III-A-3-a.

2/ Source: WFA/Basin electronic workpaper file "Exhibit_III-H-1R.xls."

3/ Source: WFA/Basin electronic workpaper file "LRS RAM Rate Reduction.xls."

4/ Source: WFA/Basin electronic workpaper file "LRR Mark-Up Rate Reduction.xls."

EXHIBIT
III-H-7
REDACTED

EXHIBIT 1B

WFA/BASIN'S REBUTTAL EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

**PERCENT REDUCTION AND OTHER METHODS
FOR ALLOCATING SAC RATE RELIEF**

calculations are vastly overstated for the reasons set forth in Parts III-B, C, D, E and F above.

3. LRR SAC Rates

As shown in Rebuttal Table III-H-1, the present value of the LRR's expected revenues exceeds the present value of the LRR's costs by approximately \$1,524.0 million. Accordingly, the LRR revenues must be reduced to equal the LRR's 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 Guidelines "leave[] the inquiry to a case-by-case analysis." Id.

In their opening evidence, WFA/Basin demonstrated that the Board should not apply its flawed percentage reduction method to set movement-specific LRR rates in this case. Instead, WFA/Basin urged the Board to apply the reasonable allocation method ("RAM")² or, if the Board chose to continue to utilize a percentage reduction method, to modify its current approach using WFA/Basin's proposed Reduced Mark-Up allocation procedure.³

On Reply, BNSF includes a long-winded discussion of how the STB should set movement-specific LRR SAC rates, even though, under BNSF's evidence,

² See WFA/Basin Op. Narr. at III-H-13 to 33.

³ Id. at III-H-34.

WFA/Basin is entitled to no rate relief.⁴ Obviously, BNSF has little faith in its LRR SAC revenue and cost calculations – and with good reason. BNSF’s reply endeavors to defend the Board’s current percentage reduction procedure, attacks WFA/Basin’s RAM and Reduced Mark-Up methods, and introduces two new methods to set LRR movement-specific SAC rates – an avoidable cost method and a through rate percentage reduction method. Finally, BNSF asks that the STB set mine-specific LRR maximum rates. As discussed below, BNSF’s contentions are all misguided and without any factual, legal or theoretical support.

a. **The Board’s Flawed Percentage Reduction Methodology**

The Board’s percentage reduction methodology has a fundamental flaw – the defendant carrier’s initial starting tariff rate dictates the resulting maximum SAC rate.⁵ This fundamental flaw must be rectified. As the Board acknowledged in CPL, “the railroad should not be allowed to ... pre-ordain the outcome of the case through the selection of the rate level to which the percentage reduction approach would be applied.”⁶

BNSF unwittingly provides an example that demonstrates the percentage reduction method is arbitrary. BNSF hypothesizes a case where its tariff allows WFA/Basin to ship LRS traffic at no charge. BNSF opines that under the percentage

⁴ See BNSF Reply Narr. at III.H-6 to 31.

⁵ See WFA/Basin Op. Narr. at III-H-10 to 13.

⁶ CPL at 33.

reduction method, WFA/Basin would be entitled to a rate reduction – a result BNSF characterizes as “produc[ing] illogical and totally unreliable results.”⁷ Of course, BNSF does not provide WFA/Basin with free coal transportation. The practical problem with percentage reduction is not tariff rates that are extraordinarily low, but tariff rates that are extraordinarily high. High tariff rates produce high percentage reduction answers – as BNSF knows. Nevertheless, BNSF’s example illustrates the arbitrariness inherent in the Board’s percentage reduction methodology.

In this case, BNSF has imposed draconian rate increases that produce tariff rates at levels never seen before in the western coal transportation markets. BNSF’s actions follow what appears to be a pattern – BNSF is progressively increasing rates in each successive maximum rate case.⁸ The Board’s percentage reduction method encourages and incites BNSF to take such the actions because, in the end, BNSF’s starting tariff rates control the STB’s SAC rate answer.

**b. BNSF’s Commercial
Reasonableness Gyrations**

BNSF opines that it is not “gaming” the percentage reduction process because its tariff rates, and the procedures it uses to adjust those rates, are “commercially

⁷ BNSF Reply Narr. at I-7. BNSF’s hypothetical is overstated since the Board will not set a maximum rate at less than 180% of the defendant carrier’s variable service costs.

⁸ See WFA/Basin Op. Narr. at III-H-13.

reasonable.”⁹ BNSF argues that it is acceptable for the Board to apply the percentage reduction test where the carrier’s starting tariff terms are “commercially reasonable.”

BNSF’s commercial reasonableness test fails for several interrelated reasons:

First, BNSF’s commercial reasonableness test focuses on BNSF’s subjective intent – i.e., why BNSF decided to impose the LRS tariff rates. The Board need not go down this diversionary path. Regardless of a carrier’s intent, the percentage reduction method permits the carrier to dictate the regulatory answer.

As WFA/Basin explained in their opening evidence, the law requires the Board to make an independent judgment on whether BNSF’s tariff rates are unreasonably high. See 49 U.S.C. §10701(d)(1). The Board cannot make such decisions and cannot fulfill its statutory mandate to engage in “meaningful rate regulation”¹⁰ if BNSF – not the Board – sets the regulatory answer via its choice of the initial tariff rates.

Second, BNSF’s rate actions speak for themselves. BNSF has imposed massive -- and unprecedented -- rate increases on the LRS traffic. The resulting rates are grotesquely high when measured against any common transportation metric, including the following:

- BNSF’s rate increases initially more than doubled the expiring LRS contract rates and then the more-than-doubled rates will more-than-double again over the

⁹ See BNSF Reply Exhibit III.A-5.

¹⁰ Farmers Union Cent. Exch. Inc. v. FERC, 737 F.2d 1486, 1507 (D.C. Cir. 1984).

20 year DCF period.¹¹ No coal shipper has ever been faced with percentage increases of this magnitude.

- BNSF's massive rate increases translate into massive payment increases for the high-volume LRS traffic. In the last year of their LRS contract, WFA/Basin paid approximately { } to BNSF.¹² In 2005, WFA/Basin will pay approximately { }, an increase of { }.¹³ By the end of 2007, the annual increase in payment is projected at over { }.¹⁴ During the 20 year DCF period, the total increase is over \$1 billion.¹⁵ 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%.¹⁶ The system-average R/VC ratio BNSF needed to be considered revenue adequate in 2004 equaled 144%.¹⁷ BNSF's initial 4Q04 tariff rates produced average R/VC ratios of

¹¹ See WFA/Basin Op. Narr. Part IV.

¹² WFA/Basin Rebuttal electronic workpaper "LRR Traffic and Revenues _WFABasin Rebuttal_Alt.xls."

¹³ Id.

¹⁴ Id.

¹⁵ WFA/Basin Op. electronic workpaper "LR 20 Year Rate.xls."

¹⁶ WFA/Basin Rebuttal electronic workpaper "BNSF RVC Ratios 2004.xls."

¹⁷ Id.

478%.¹⁸ These averages will increase to 649% in 2007 and, by the end of the DCF period, will exceed 847%.¹⁹

- BNSF's system-average rates per revenue ton-mile equaled 9.6 mills in 2004.²⁰ BNSF's initial 4Q04 tariff rate (with surcharges) equaled 38.2 mills.²¹ These averages will increase to 44.5 mills in 2007²² and, by the end of the DCF period, will exceed 88.0 mills.²³

- As shown in Rebuttal Exhibit III-H-2, WFA/Basin is now paying per ton rates that are substantially higher than the rates BNSF is charging on movements that are hundreds of miles longer than the LRS movement.

Third, BNSF must go through evidentiary gyrations of epic proportions to support its claim that BNSF based the massive LRS rate increases on so-called "commercial" factors – not regulatory factors (i.e., the Board's percentage reduction methodology).

¹⁸ See WFA/Basin Rebuttal electronic workpaper "VC WFA 2004 Summary Rebuttal2.123."

¹⁹ See WFA/Basin Rebuttal electronic workpaper "LRS_RVCRebuttal v5.xls."

²⁰ See WFA/Basin Op. electronic workpaper "LRS_BNSF_ratesandrvc.xls."

²¹ See WFA/Basin Rebuttal electronic workpaper "LRR Traffic and Revenues_WFABasinRebuttal_Alt.xls."

²² Id.

²³ Id.

During discovery, and thereafter, WFA/Basin has repeatedly requested BNSF to provide internal documents explaining why BNSF decided to impose massive rate increases on the LRS traffic. BNSF has stonewalled in response. BNSF has not submitted a single internal e-mail, memorandum or other document prepared by any BNSF official that explains the real basis for its tariff pricing actions. All of the documents are being withheld under the attorney/client privilege.²⁴

BNSF proceeds to create a made-for-litigation explanation for its pricing actions. On Opening, the explanation was provided by Professor Kalt. He claimed BNSF relied on “commercial” factors to set the LRS rates. On Reply, BNSF witness Brautovich, a BNSF marketing official, parrots Professor Kalt’s asserted commercial justifications for BNSF’s pricing actions.²⁵ Neither Professor Kalt nor Mr. Brautovich produced any internal BNSF prepared documents that explain BNSF’s pricing actions. These documents are still being withheld.

BNSF is forced to go through these complex evidentiary hoops to avoid disclosing an obvious fact – BNSF management was aware of how the Board’s percentage reduction process works and set its tariff rates accordingly.

Fourth, BNSF’s alleged “commercial justifications” for its tariff actions have no basis in fact. As WFA/Basin demonstrated in their reply evidence, BNSF is not a

²⁴ See WFA/Basin Reply Narr. at IV-2 to 3.

²⁵ See BNSF Reply Exhibit III.A-5.

benign “commercially reasonable” monopolist. A review of BNSF’s make-weight commercial defenses for its pricing actions demonstrates these facts:

- BNSF argues that its price actions are justified because the expiring LRS contract rates were “low.”²⁶ That is not true. As WFA/Basin demonstrated in their opening and reply evidence, the LRS contract was very lucrative to BNSF. During the term of the contract, the R/VC ratios on the LRS traffic exceeded 200% – returns that substantially exceeded BNSF’s system-average R/VC ratios (e.g., 131% in 2004) and the ratios BNSF needed to reach revenue adequacy (e.g., 144% in 2004).²⁷ Overall, BNSF earned more than \$311 million in profit from the LRS traffic during the contract term.²⁸

- BNSF argues that its tariff pricing actions are justified because LRS delivered coal costs, and LRS electric generation costs, are lower than those at other coal-fired plants BNSF has identified. BNSF’s plant analysis is skewed. Many of the plants it cites obtained coal from non-Wyoming PRB mines. As shown in Exhibit III-H-3, the price of the coal from these non-Wyoming PRB areas is significantly higher than LRS PRB coal prices. Similarly, the PRB-coal fired plants included in BNSF’s study group include many plants with substantially longer PRB coal hauls than the LRS haul.

²⁶ BNSF Reply Exhibit III.A.5 at 3.

²⁷ See WFA/Basin Op. electronic workpaper “BNSF Contribution_LRS Contract.xls.”

²⁸ Id.

In the end, BNSF's plant analysis demonstrates that BNSF wants to use its monopoly power to increase WFA/Basin's production prices so that BNSF – not WFA/Basin's customers – benefit from WFA/Basin's decision to utilize PRB coal and to site the LRS plant close to the PRB. The Board's predecessor, the ICC, properly referred to this form of monopoly carrier pricing as "extort[ion]." ²⁹

- BNSF argues that WFA/Basin should pay higher rates because the "recent high demand for PRB coal and PRB coal transportation services, with corresponding need to increase capital investment, has led BNSF to seek higher PRB coal transportation rates." ³⁰ "High demand" for PRB coal is not a recent phenomenon. BNSF's own evidence shows that the market for PRB coal has gone from 100 million tons in 1980 to nearly 500 million tons in 2004. ³¹ WFA/Basin, and other utilities, have made this market for BNSF. And this market has been a highly profitable one for BNSF – as most recently confirmed in an extensive AASHTO Study. ³² The AASHTO Study shows that BNSF has earned substantial profits on its coal traffic at historic pricing levels. These profits – which include the substantial profits BNSF earned under the expired LRS

²⁹ In re: Investigation of Advances in Rates by Carriers in Western Truck Line, Trans-Missouri and Illinois Freight Committee Territories, 20 I.C.C. 307, 350-51 (1911).

³⁰ BNSF Reply Exhibit III.A-5 at 3.

³¹ Id.

³² See AASHTO Study at 117; WFA/Basin Reply electronic workpaper "Freight Rail Report.pdf."

contract – have been more than enough to finance infrastructure growth, and will continue to do so in the future.³³

- BNSF argues that its pricing actions are justified because it wants the additional revenue, WFA/Basin's customers can "absorb" its rate increases, etc.³⁴

WFA/Basin have already addressed these arguments in detail in their reply filing, and will not repeat that discussion again. Suffice it to say here that BNSF's arguments highlight the fact that BNSF is a monopolist, the LRS plant is captive to BNSF, and, left to its own devices, BNSF feels no compunction whatsoever to use its monopoly power to extract punitive monopoly profits from WFA/Basin's rural electric and small municipal customers.³⁵

Fifth, the Board adjudicates the reasonableness of coal rates by applying the regulatory standards set forth in the Coal Rate Guidelines. The Guidelines do not contain the "commercial reasonableness" test BNSF posits. Accordingly, the STB has no legal basis to apply it.

BNSF's commercial reasonableness test also does not address the question of what the Board should do if the Board finds that BNSF's tariff rates are "commercially

³³ Id.

³⁴ BNSF Reply Exhibit III.A-5 at 5.

³⁵ BNSF also argues its pricing actions are justified based upon a study prepared by a consultant – Norbridge, Inc. However, BNSF has repeatedly refused WFA/Basin's requests to produce this study and the workpapers supporting it.

unreasonable.” Is the Board to unilaterally reduce BNSF’s tariff rates to some “commercially reasonable level” if it finds the tariff rate to be “commercially unreasonable?” BNSF does not address these questions for obvious reasons: the Board has the statutory authority to reduce coal rates only if it finds the rates unreasonable under the Guidelines – and the Guidelines do not contain BNSF’s “commercial reasonableness” test. Instead, the Guidelines contain the regulatory SAC test to determine rate reasonableness,³⁶ and the Board uses the percentage reduction method (which BNSF controls) to set maximum SAC rates.

Finally, BNSF offers no regulatory justification for its actions because none exists. Percentage reduction incites monopoly carriers to charge high tariff rates. These high tariff rates pre-ordain the SAC answers. BNSF knows this but does not want to acknowledge it – for obvious reasons – since it (not the STB) controls the regulatory answer. The best BNSF can do is to make up a fictitious, legally meaningless side-bar test – “commercial reasonableness” – and then mistakenly claim it has passed its own self-proclaimed test.

c. The Fair Alternative – RAM

WFA/Basin utilized the Reasonable Allocation Method (“RAM”) to calculate movement-specific LRR SAC rates. Under RAM, each LRR shipper pays its variable costs. Captive LRR shippers pay an additional sum equal to a pro-rata share of

³⁶ See Guidelines, 1 I.C.C.2d at 542.

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.³⁷

As WFA/Basin explained in their opening evidence, RAM has many attributes: it is consistent with the Coal Rate Guidelines; it follows procedures the ICC initially used to set maximum SAC rates; it avoids the many problems with the percentage reduction method; and it produces results that are fair to both WFA/Basin and BNSF.³⁸

On reply, BNSF maintains that the Board should reject RAM because: (i) WFA/Basin are “gaming” the SAC process; (ii) RAM does not comply with the Coal Rate Guidelines; (iii) the RAM approach has been rejected in prior cases; and (iv) WFA/Basin have not presented sufficient evidence to support RAM.³⁹ WFA/Basin address each of BNSF’s erroneous contentions in turn.

**i. RAM Solves the Flaws in
Percentage Reduction Methodology**

BNSF’s principal contention in its reply evidence is that WFA/Basin are “gaming” the SAC process. BNSF repeats this charge ad nauseam throughout its reply. All told, BNSF makes over 60 references to “gaming.” Of course, WFA/Basin are not “gaming” the SAC process. BNSF has imposed a \$1 billion dollar rate increase on LRS’s

³⁷ See WFA/Basin Opening at III-H-28 n.34.

³⁸ See WFA/Basin Op. Narr. at III-H-29 to 33.

³⁹ See BNSF Reply Narr. at III-H-20 to 25.

rural and small municipal customers. WFA/Basin seeks rate relief under the SAC test and its evidence comports with governing Board precedent in all respects.

What really appears to be bothering BNSF is not WFA/Basin's "gaming" but, the fact that the LRR revenues – calculated using mileage-based procedures the Board has applied in its last nine (9) cases – substantially exceed the LRR's SAC. The magnitude of this differential is critical under percentage reduction since, under that method, higher differentials mathematically translate into lower movement-specific SAC rates.

RAM addresses BNSF's concerns about high SARR revenue/cost differentials. Under RAM, high differentials do not impact the SARR movement-specific SAC rates. 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 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.

More importantly, RAM addresses, and solves, the overriding problem with percentage reduction – the carrier's starting rate dictating the maximum SAC rate. The above-example also illustrates the following point: assume exactly the same hypothetical inputs shown above but further assume they apply to the complainant's traffic. Under

RAM, the carrier starting rate of \$10.00 per ton has no impact on the resulting SAC maximum rate – \$5.00 per ton. Thus, RAM closes a gaping loophole in percentage reduction – i.e., the carrier's starting rate no longer pre-ordains the resulting maximum SAC rate.

ii. RAM Complies with the Guidelines

RAM complies with the Coal Rate Guidelines. The fundamental RAM SARR revenue allocation principle is that captive shippers with reasonably similar demand elasticities can pay a pro rata share of a SARR's unattributable costs. This basic RAM principle was championed by the western railroads in the mid-1980s; was adopted by the ICC in the Guidelines; and was applied by the ICC in the first two major coal rate cases the ICC decided after it promulgated the Guidelines.⁴⁰

BNSF's truncated, and tortured, reading of the Guidelines cannot overcome what the Guidelines say and how the ICC applied them after they were issued. The gravamen of BNSF's argument is that the Guidelines permit a pro rata distribution of unattributable costs among SARR shippers only if those shippers have "identical demand characteristics" and "equal elasticities" of demand.⁴¹ BNSF's reading of the Guidelines is clearly wrong – the Guidelines expressly permit, and encourage, complainant shippers to

⁴⁰ OPPD and APL.

⁴¹ BNSF Reply Narr. at III.H-21 to 22.

allocate unattributable costs on a pro rata basis among SARR traffic group members with “similar demand elasticit[ies].”⁴²

As WFA/Basin explained in its opening evidence,⁴³ the Coal Rate Guidelines were issued in the summer of 1985. At that time the ICC had a tremendous backlog of coal rate cases. Many of these cases had been in limbo for years while the Guidelines were being formulated. As a consequence of the backlogged docket, the ICC needed not only a set of defensible ratemaking standards that could withstand judicial review, but also standards that could be implemented practically in pending cases to produce fair results.

One consequential issue the ICC knew it had to address in the Guidelines was how to calculate shipper-specific SAC rates. Without this discussion, the Guidelines would not have been of much use in solving the ICC’s underlying problem – deciding pending coal rate cases. In Guidelines, the ICC called for the determination of shipper-specific SAC rates “on the basis of Ramsey [pricing] principles.” Id. at 546. These principles allocate unattributable SAC costs to traffic group members “in inverse proportion to demand elasticities.” Id. at 554. The ICC was fully aware, however, that translating Ramsey pricing into case-specific rate relief was an impossible proposition. As stated by the ICC:

⁴² Guidelines at 533.

⁴³ See WFA/Basin Op. Narr. at III-H-17.

We did not consider it to be practical to impose pure Ramsey pricing as a regulatory requirement for across-the-board application in all cases. Ramsey pricing is based on a mathematical formula which requires both the marginal cost and the elasticity of demand to be quantified for every movement in the carrier's system. Thus, the amount of data and degree of analysis required seemed overwhelming. We concluded that while formal Ramsey pricing is useful as a theoretical guideline, it is too difficult and burdensome for universal application.

Id. at 527 (footnote omitted). Of course, impossible propositions did not solve the ICC's pending case crunch.

The ICC addressed and resolved this issue by suggesting a practical answer – shippers could evenly allocate unattributable SARR costs to SARR traffic group members that shared similar demand elasticities. Thus, the Guidelines provide:

We will consider evidence that particular [SARR] shippers face similar market conditions and therefore have similar demand elasticity.

Id. at 533. The ICC also held that shippers could present practical, qualitative evidence to demonstrate these similar demand elasticities:

[w]here information on demand elasticity is required ... we will consider qualitative (rather than necessarily quantitative) evidence on the relative demand elasticity of specific movements and/or commodities.

Id. at 527.

The ICC's solution found support in the filings made by a large group of western railroads ("Western Railroads") that included BNSF's corporate predecessors. In their comments, the Western Railroads urged the ICC to set shipper specific SAC rates by allocating a "pro-rata sharing of costs" to "movements of the same commodity – or at the very most, commodities the transportation of which (if not identical) is characterized by similar elasticity of demand."⁴⁴

The ICC proceeded to apply these elasticity principles in its landmark OPPD⁴⁵ and APL⁴⁶ decisions. Each of these cases involved a shipper challenge to carrier rates from the PRB to its utility plant. In each case the shipper designed a SARR to provide PRB-to-plant service. The ICC found in each case that SARR revenue exceeded SARR costs, and also adopted the shippers' proposed method to determine SARR-specific SAC rates. That method called for each SARR shipper to pay its variable costs. The remaining unattributable SARR costs were distributed on a pro rata ton-mile basis among the SARR's coal shippers – all of whom were captive shippers.

The ICC found in each case that this distribution of unattributable costs was permissible because the Guidelines permitted shippers to allocate these costs among

⁴⁴ Comments of Western Railroads, ICC Ex Parte No. 347 (Sub. No. 1)(filed July 28, 1983) at 75 (emphasis in the original), excerpted in WFA/Basin Op. Workpapers Vol. 11, pp. 6447-6451.

⁴⁵ 3 I.C.C. 2d 123 (1986).

⁴⁶ 3 I.C.C. 2d 757 (1987).

traffic group members "with reasonably comparable elasticities of demand." As stated by the ICC in OPPD:

As noted, Omaha Power distributed all unattributable costs of [the SARR] system uniformly over all unit-train coal shipments, the hypothesis being that the strength of demand for each coal shipper is sufficiently similar to recover an average contribution. The qualitative evidence for OPPD's methodological short-cut is derived principally from the fact of similarity among members of the group. The grouping consists of the same commodity, shipped from the same general origin, with similar unit-train service characteristics, destined for the same end use (consumption in domestic electric utility plants).

* * *

In deciding this issue ... we do not withdraw from the principle that allocation of unattributable costs among captive shippers is based ideally on relative demand elasticities. Indeed, complainant has not asked for repudiation of this principle. In complainant's view,

* * * the issue comes down to the extent to which it is feasible, *given the facts in each contested proceeding*, to make groupings of shipments with reasonably comparable elasticities of demand * * * without jeopardizing the ability of the railroad to recover its aggregate stand-alone costs.

We agree with this formulation....

Id. at 139-40 (emphasis in original).

Similarly, the ICC held in APL:

We find that in this case [Arkansas Power & Light's] assumption regarding the like elasticity for its group is reasonable and we accept it. As in *Omaha*, the non-issue traffic consists of the same commodity (coal), with similar service characteristics (unit-train service), destined for the same end use (consumption in electric utility plants), and shipped from the same general origin (Powder River Basin). On this record, we are satisfied that any degree of variation in the demand elasticities of the non-issue shippers is not significant and therefore each shipper can reasonably be assigned an equal portion of the non-attributable costs of the stand-alone system.

Id. at 774.

Thus, BNSF clearly misinterprets the Guidelines. The Guidelines do not limit pro rata sharing of SARR unattributable costs to situations where SARR traffic group member have "identical" demand elasticities. Instead, the Guidelines, as authoritatively and contemporaneously construed and applied by the ICC in OPPD and APL, permit shippers to make pro rata allocations of SARR unattributable costs to SARR shippers that "face similar market conditions and therefore have similar demand elasticity."⁴⁷

⁴⁷ Guidelines at 533.

**iii. RAM has not been
Rejected in Prior Cases**

BNSF argues that the Board has “rejected” RAM in prior cases.⁴⁸ That is simply not correct. The RAM procedure is modeled on the methodology that the ICC used and approved in OPPD and APL to set SARR-specific SAC rates. In those cases, all SARR shippers paid their variable costs and captive coal shippers paid the unattributable costs on a pro rata ton-mile basis. The ICC approved the pro rata distribution of unattributable costs because the complainant shipper demonstrated that the group of captive PRB coal shippers had similar elasticities of demand.

In cases presented and decided since OPPD and APL, complainant shippers have not asked the ICC, or the STB, to apply a procedure where each SARR shipper pays its variable costs and unattributable SAC costs are distributed among a class of shippers with similar demand elasticities. Thus, the ICC and the Board have not rejected the methodology used in OPPD and APL – and the methodology RAM is based upon – because it has not been presented in subsequent cases.

The ICC, and the Board, however, have considered – and rejected – other methodologies involving pro rata distribution of all SAC costs, but these cases are distinguishable on their facts.

⁴⁸ See BNSF Reply Narr. at III.H-22.

• In Coal Trading,⁴⁹ the complainant shippers challenged rates posted by two carriers (CSX and NS) to apply from coal mines located in five eastern states to three eastern export coal piers. All told, the complaint covered 507 origin-to-destination pairs. The complainants' SARR included both competitive and captive shippers moving coal from different eastern coal producing regions to different ports for export.

The complainants in Coal Trading asked the ICC to set movement-specific SAC rates by allocating all SAC costs on a ton-mile basis, not just unattributable SAC costs.⁵⁰ And, the complainants did not – because they could not – demonstrate that all members of their SARR traffic group had similar demand elasticities. The ICC, in an interim decision, issued a preliminary ruling that, on the facts presented, the complainants' ton-mile allocation approach, “preclude[ed] differential pricing.”⁵¹ The case went on to settle before the ICC entered a final decision and the “proceeding was discontinued without a rate prescription.”⁵²

Coal Trading is clearly distinguishable from the instant case. Here, unlike Coal Trading, all SARR traffic originates in a single coal producing area (the PRB); the coal is originated by a single carrier (BNSF); and, unlike the case in Coal Trading,

⁴⁹ 6 I.C.C. 2d 361 (1990).

⁵⁰ Id. at 380.

⁵¹ Id.

⁵² WTU, 1 S.T.B. at 716 n.171.

WFA/Basin demonstrate that a pertinent subset of the LRR traffic group (the captive coal shippers) does have similar demand elasticities. Accordingly, a pro rata distribution of unattributable costs in this case, unlike Coal Trading, does permit differential pricing.

- In WTU, WTU challenged BNSF's rates from the PRB to WTU's Oklaunion generating station, near Vernon, Texas. WTU's SARR consisted of PRB coal shippers – some were captive and others competitive.⁵³ WTU asked the Board to distribute all SAC costs (not just SARR unattributable costs) on a pro rata basis amongst its traffic group members. BNSF asked the Board to utilize the percentage reduction method to set the SARR members' SAC rates. The STB held that “[w]e need not address the validity of either of the parties proposed methods, because both WTU's and BN's suggested methods would result in an R/VC percentage of less than 180.”⁵⁴

WTU is distinguishable from the current case, inter alia, because WTU's proposed allocation method (unlike RAM) did not allocate unattributable SARR costs solely to the captive coal shippers in its SARR. And, as noted above, the STB did not decide the revenue allocation issue.

⁵³ The WTU traffic group consisted of eleven PRB coal shippers. Nine were served by a single railroad at destination. Two (SPS at Tolk and NPPD at Gerald Gentlemen) were competitive since the generating plants were served by two rail carriers. See WTU at 657-664.

⁵⁴ WTU at 716.

- In APS I,⁵⁵ APS challenged BNSF's rates on APS coal traffic originating at Gallup, New Mexico and terminating at APS's Cholla Station in Joseph City, Arizona. The APS traffic group included only two coal shippers – APS and Salt River Power Project – and two O/D pairs.

APS asked the STB to allocate all SARR costs on a ton-mile basis between the APS and Salt River SARR traffic. BNSF asked the Board to apply the percentage reduction method. The Board found that APS and Salt River had similar demand elasticities but chose not to apply APS's ton-mile allocation method because "the long-run marginal cost of serving these shippers would appear to differ significantly."⁵⁶ The Board also noted that APS's "ton-mile allocation method could potentially yield a rate for a non-complaining shipper that is higher than the rate actually paid by that shipper."⁵⁷

WFA/Basin's RAM methodology solves both of the issues the STB raised in APS. Under RAM, shippers (including WFA/Basin) pay all of their long-run marginal costs since – subject to the default rule – each SARR shipper pays its variable costs. The RAM default rule also caps each SARR shipper's rates at its current level – thus precluding a non-complainant shipper from paying more than its current rate.

⁵⁵ 2 S.T.B. 367 (1997).

⁵⁶ Id. at 392 n.73.

⁵⁷ Id. at 392 n.72.

- In CPL,⁵⁸ Carolina Power & Light (“CP&L”) challenged coal rates established by NS on CP&L coal traffic moving from various origins in three eastern states to two CP&L generating stations in North Carolina. The CP&L SARR served captive and competitive coal customers, and also transported grain.

CP&L contended that NS had “gamed” the percentage reduction process by imposing tariff rates that were fifty percent higher than its expiring contract rates for the involved movements.⁵⁹ CP&L proposed various methods to solve the gaming issue, including a “‘ton-mile approach’ under which the total revenue requirements of the SARR would be distributed among the traffic in the stand-alone group on a ton-mile basis so that all traffic in the group would contribute the same per-ton-mile amount.”⁶⁰ The Board rejected CP&L’s suggested allocation method because, the Board found, it “would not allow for demand-based differential pricing.”⁶¹ The Board went on to explain that “[i]f a railroad attempted to collect the average per-ton-mile amount from all of its traffic, competitive traffic that is lower-priced would shift to other transportation options, depriving the railroad of the revenues assigned to that traffic.”⁶²

⁵⁸ STB Docket No. 42072 (STB served Dec. 23, 2003).

⁵⁹ Id. at 31.

⁶⁰ Id. at 33.

⁶¹ Id.

⁶² Id.

RAM solves the Board's concerns in CPL. Under RAM, SARR shippers do not contribute the same amount per ton. Each shipper pays its variable service costs (which differ from shipper to shipper depending on the length of the shipper's haul on the LRR, and the movement-specific characteristics of the traffic). And, under RAM, only captive shippers pay amounts in excess of their variable costs. Thus, under RAM, competitive traffic would not "shift to other transportation options"⁶³ because, unlike the case in CPL, LRR competitive shippers are not asked to make any contribution to the LRR's fixed costs, much less a pro rata ton-mile allocation of all SARR costs.

* * *

BNSF is simply wrong when it says RAM has been rejected in prior cases. The RAM approach – having all LRR shippers pay their variable costs, and allocating SARR unattributable costs only to the captive traffic, was utilized in OPPD and APL. No subsequent complainant shipper – prior to the instant case – has asked the ICC or the Board to employ this accepted methodology. As shown above, Coal Trading, WTU, APS I and CPL involved shipper proposals to use different methods to calculate movement-specific SARR rates than RAM. RAM also addresses and corrects the problems the ICC and the Board identified with these other methodologies.

⁶³ Id.

iv. The Record Supports RAM

BNSF argues that WFA/Basin have not submitted sufficient evidence to support RAM. BNSF's various evidentiary points are wrong.

- BNSF claims the Guidelines require a shipper to demonstrate that SARR members have "identical" demand elasticities before they are asked to share a pro rata allocation of unattributable SARR costs. As discussed above, BNSF mistakes what the Guidelines require. The Guidelines permit shippers to allocate unattributable costs, on a pro rata basis, to "shippers [that] face similar market conditions and therefore have similar demand elasticity."⁶⁴

- WFA/Basin presented extensive qualitative evidence on Opening demonstrating that the captive coal shippers in the LRR "face a similar market condition and therefore have similar demand elasticity."⁶⁵ The evidences demonstrated, inter alia:

- WFA/Basin limited their captive traffic group to sub-bituminous coal – a commodity that constitutes 0.003% of the total commodities carried by rail.

- Each LRR captive shipper originates its coal from the same producing area (the PRB), each LRR captive shipper has the coal transported in the same form of service (unit train service), and each LRR captive shipper's coal is delivered to similar destinations (utility coal-fired power plants).

⁶⁴ Guidelines, 1 I.C.C. 2d at 533.

⁶⁵ See WFA/Basin Op. Narr. at III-H-25 to 28.

– Each LRR captive shipper is sole-served by BNSF or LRR. The Board has consistently acknowledged the substantial market power that a railroad has over pricing to its sole-served utility coal customers.⁶⁶ Similarly, the Board’s predecessor, the ICC observed: “long-haul, large-volume, heavy-loading traffic such as coal is likely to be captive to rail, and hence have relatively low demand elasticity.”⁶⁷

– The LRR captive coal traffic is delivered to base-load coal-fired facilities.⁶⁸ Base-load plants are typically must-run plants a utility needs to operate to meet its native load.⁶⁹ Railroad pricing power is at its highest – and shipper price elasticity is at its lowest – for coal transportation to captive base-load plants.⁷⁰

– The criteria WFA/Basin utilize to classify utility coal movements as competitive or captive are identical to the criteria BNSF has itself used in its recent submissions in coal rate cases.⁷¹ In these submissions, BNSF has acknowledged the

⁶⁶ See TMPA at 11; WTU at 648-52; APS I at 374-79.

⁶⁷ Coal Rate Guidelines – Nationwide, 364 I.C.C. at 360, 365 (1980).

⁶⁸ Base load plants are defined as having a “nominal annual capacity factor of 65%.” APS I at 377 n.24. {
}

⁶⁹ See WTU, 1 S.T.B. at 653.

⁷⁰ Id. at 652-654; APS I at 377-79; APS II at 72-74.

⁷¹ See Reply Evidence of The Burlington Northern and Santa Fe Railway Company in Docket No. 41191 (Sub No. 1), AEP Texas v. BNSF, Public Version at III-A-99, and Reply Evidence of The Burlington Northern and Santa Fe Railway Company in Docket No. 42071, Otter Tail Power v. BNSF, Public Version at III-A-111 to 112.

practical demand-based differences between competitive and captive sole-served plants.

- BNSF does not dispute or challenge WFA/Basin's evidence

demonstrating that LRR captive shippers have reasonably similar demand elasticities.

Nor does BNSF dispute that WFA/Basin have met their burden of proof under the standards set forth OPPD and APL. In these cases, the ICC found that the shipper met its burden to show "similarity [of demand elasticities] among members of the [SARR] group"⁷² by presenting evidence demonstrating "[t]he grouping consists of the same commodity, shipped from the same general origin, with similar unit-train service characteristics, destined for the same end use (consumption in domestic electric utility plants)."⁷³

Instead, BNSF argues that shippers within the LRR traffic group have different elasticities of demand because they have differing generating capabilities. BNSF theorizes that some utilities in the LRR traffic group can respond to the BNSF price increases at the LRR captive group plants by substituting power from other, lower-cost generating facilities within their systems, or by purchasing lower cost power on the electric grid. These asserted grid options, BNSF further theorizes, allow some LRR shippers to "discipline" BNSF if its prices get too high.⁷⁴

⁷² OPPD, 3 I.C.C. 2d at 139-40.

⁷³ Id.

⁷⁴ See BNSF Reply Narr. at III.H-24.

BNSF's contentions here are far-fetched. The LRR captive plants are low-cost base load generators. BNSF exerts tremendous market power over all of these plants because of the wide spread differential between the delivered fuel costs at these plants and delivered fuel costs for other generating facilities (e.g., gas fired generation).⁷⁵

At some point, BNSF, like any other monopolist, can price itself out of a market. As the D.C. Circuit once observed, "[a]t some point the availability of an alternative such as the horse and buggy or even people carrying [the involved commodity in] buckets theoretically prevents railroads from raising their rates beyond an outer bound."⁷⁶ Here the LRR traffic group shippers face similar electric generating market conditions – conditions that give BNSF tremendous pricing power over their transportation service.

BNSF also opines that a utility with multiple plants may have lower elasticity of demand transportation than a utility with few plants. BNSF's submissions in recent STB cases also directly conflict with its contentions in this case. For example, in Xcel, Xcel challenged BNSF's rate from the PRB to the Pawnee power plant in Colorado – a generating station that is captive to BNSF. Xcel has many other generating plants. In Xcel, BNSF did not argue that Xcel's ownership of other generating stations, or its access

⁷⁵ BNSF touts these spreads – and BNSF's corresponding market power – in its presentation to Wall Street analysts. See WFA/Basin electronic workpaper "Financial Analysts.pdf" at "Demand Drivers."

⁷⁶ Arizona Pub. Serv. Co. v. United States, 742 F.2d 644, 650-51 (D.C. Cir. 1984).

to the electric grid, provided Xcel with any practical market leverage against BNSF. Instead, BNSF candidly acknowledged that Xcel “was one of BNSF’s most demand-inelastic shippers.”⁷⁷

The Board made similar findings in the WTU case. In that case, BNSF argued that WTU could discipline BNSF by swinging power generation away from its captive Oklaunion plant to other plants in the CSW system. The Board rejected this contention:

Oklaunion is the lowest-cost unit in the WTU system. As such, it operates as a “base-load, must run” plant. In an economic dispatch system, a utility dispatches its lowest-cost generation first to serve its “native load.” Because other utilities tend to use their least expensive incremental generation for their own territorial customers, the power that would be available for regular transfer between utilities is typically the highest-cost power, not the lowest. Therefore, obtaining power from other sources – whether from other CSW utilities or from elsewhere on the power grid – would not be an economical alternative to Oklaunion’s output.

Id. at 653.

BNSF also theorizes that a shipper with multiple plants may be able to obtain competitive leverage by packaging competitive plants and captive plants together

⁷⁷ See Rebuttal Evidence and Argument of the Burlington Northern and Santa Fe Railway Company in Xcel dated May 19, 2003 at page I-8 (Public Version).

in a bidding competition.⁷⁸ However, any such strategy cannot work. A profit maximizing carrier serving a shipper's captive and competitive plants will try to win business at the competitive plants by submitting a bid that "just beats" other carriers' bids, while maximizing its prices at the captive plant (up to the maximums permitted under the Guidelines).

**d. WFA/Basin's Other
SAC Relief Methods**

In their opening evidence, WFA/Basin asked the Board to set SARR-specific rates using RAM. WFA/Basin also calculated SARR-specific rates using the Board's current percentage reduction methodology – but asked the Board not to use this approach. Finally, WFA/Basin presented the Board with a third alternative – the Reduced Mark-Up method. The Reduced Mark-Up method is intended to work in the general form of the Board's current, flawed percentage reduction methodology but it makes some obvious corrections – e.g., it reduces SARR shippers' profit contributions, not simply their rates.

Under the Reduced Mark-Up method, the profit contribution made by each LRR shipper is calculated. The profit contribution is the difference between the revenues paid by each LRR shipper and the variable costs the LRR incurs to provide that shipper

⁷⁸ See BNSF Reply Narr. at III.H-25.

with service. The contribution is then reduced on a pro rata basis so that LRR revenues equal LRR costs.⁷⁹

The Reduced Mark-Up method uses R/VC ratios as a surrogate for Ramsey demand elasticity calculations. It also responds to the Board's Xcel I decision. In Xcel I, the Board criticized Xcel's proposed R/VC ratio methodology for determining movement-specific SARR rates because "all movements in the traffic group with R/VC percentages in excess of the R/VC cap would be expected to bear equal shares of the SAC costs on an R/VC basis, even where they have differing demand elasticities."⁸⁰

The Reduced Mark-Up method, unlike the method the Board rejected in Xcel, does not require LRR group members "to bear equal shares of the SAC costs ... even where they have differing demand elasticities."⁸¹ Instead, the Reduced Mark-Up method provides for each LRR shipper to bear different shares of SAC costs based on the profit contribution.

BNSF argues that the Reduced Mark-Up method should be rejected because it (i) is "inconsistent" with RAM; (ii) does not address "through" movement revenues and

⁷⁹ See WFA/Basin Op. electronic workpaper "LRR Mark-Up Rate Reduction.xls."

⁸⁰ Xcel I at 38.

⁸¹ Id.

costs; (iii) improperly uses LRR costs, not BNSF's costs; and (iv) improperly relies on URCS costs to calculate marginal costs.⁸² Each contention is addressed below.

- BNSF's claims that RAM and Reduced Mark-Up methods are "inconsistent" with the purpose of each method. RAM is intended to replace percentage reduction with a superior approach.⁸³ The Reduced Mark-Up method simply endeavors to take the flawed percentage reduction approach and, within the flawed contours of the methodology, redirect its focus from rate reduction to contribution reduction.⁸⁴ As WFA/Basin demonstrated on opening, RAM produces conservative results when compared to the Reduced Mark-Up method.

⁸² See BNSF Reply Narr. at III.H-25 to 28.

⁸³ See WFA/Basin Op. Narr. at III-H-29 to 33.

⁸⁴ Both RAM and Reduced-Mark-Up start with a calculation of LRR variable costs. RAM and Reduced-Mark-Up use different procedures to allocate unattributable costs. WFA/Basin's Reduced Mark-Up approach takes a "snapshot" approach by using R/VC ratios as a substitute for Ramsey pricing elasticities. R/VC ratios at any time can reflect a number of factors. A principle factor impacting captive coal traffic R/VC ratios is the Board's application of the Coal Rate Guidelines. Carriers look to the Board's application of these Guidelines in setting maximum coal rates. See WFA/Basin Op. Narr. at III-H-32. Thus, the rate levels on captive coal traffic generally reflect regulatory policies that are intended to preclude carriers' from earning excessive profits on captive coal traffic. RAM takes a longer-term view by looking at basic coal transportation market demand fundamentals. For example, the R/VC ratios on the LRS traffic jumped dramatically when the LRS contract expired and BNSF imposed its massive tariff price increases. The LRS plant was captive to the BNSF both before and after the price increases, and the price increases were not predicated upon any change in the LRS plant's transportation demand elasticity. Rather, they reflected BNSF's STB rate litigation strategy.

WFA/Basin also observe that BNSF has presented to the Board a new methodology to replace percentage reduction as well as approaches that modify percentage reduction. These different approaches employ wildly different theoretical underpinnings,⁸⁵ but, of course, BNSF sees no harm in its presenting “[in]consistent” methodologies to the Board.

- BNSF argues that the Reduced Mark-Up methodology should be rejected because it does not utilize through movement revenues and costs.⁸⁶ This contention is far-fetched. The Board’s SAC methodology calculates SARR revenue and SARR costs. The issue in this case, and others, is the method for calculating movement-specific SARR rates where SARR revenue exceed SARR costs. Through movement revenue (i.e., the LRR’s revenue + BNSF’s revenue) and through costs (i.e. the LRR’s costs + BNSF’s costs) play no roles here. The issue is how to set movement-specific rates on the SARR – a carrier that is separate from BNSF and has its own separate revenue and cost structures.

- Similarly, BNSF’s arguments that the LRR should utilize BNSF’s costs for distributing LRR revenues are wrong. The LRR has its own cost structure which is different than BNSF’s. No real world carrier would rely on another carrier’s costs in setting its rates – it would, of course, look to its own costs.

⁸⁵ See BNSF Reply Narr. at III.H-6.

⁸⁶ Id. at III.H-27.

• Finally, BNSF argues that URCS costs are not an accepted surrogate for long run marginal costs needed to calculate Ramsey prices.⁸⁷ However, the STB has ruled otherwise. As stated by the Board, “[b]ecause the marginal costs associated with handling particular rail traffic are not readily measurable, we rely on the variable costs produced by the URCS formula as proxy for LRMC [long run marginal costs].”⁸⁸

BNSF also forgets the purpose of the Reduced Mark-Up method. Ramsey pricing calls for a calculation of profit contributions. In a SAC analysis, these contributions must be reduced if they generate SARR revenues in excess of the SARR’s revenue requirements. Percentage reduction, as the Board currently applies it, simply reduces rates without any consideration of contribution.

e. **BNSF’s Rate Relief Methods**

BNSF serves up two methods to determine shipper-specific SARR rates – avoidable costs and a modified percentage reduction approach.

i. **Avoidable Costs**

BNSF’s misguided calculation of “avoidable cost” divisions is discussed above in Part III-A. Under BNSF’s flawed methodology, the LRR’s initial revenue divisions are set at BNSF’s URCS 4Q04 variable costs for providing LRR service, and the LRS rates are set at BNSF’s 4Q04 tariff levels. BNSF proceeds to adjust the 4Q04

⁸⁷ Id. at III.H-27 n.19.

⁸⁸ Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1027 (1996).

divisions for future time periods using the RCAF-A and adjust the LRS rates using its forecast of the tariff adjustment procedures.

Under BNSF's approach, if LRR SAC revenues exceed LRR SAC costs, the overages should be used to reduce the LRS rates.⁸⁹ Of course, BNSF's avoidable cost divisions methodology ensures that LRR revenues will never exceed LRR costs since, under BNSF's approach, the LRS traffic is required to pay all unattributable SARR costs above the BNSF URCS variable costs.

BNSF's avoidable cost maximum rate relief methodology must be rejected because it vastly understates divisions on cross-over traffic and – by design – requires the LRS traffic to pay a vastly disproportionate share of the LRR's unattributable costs for the 218-mile LRR route (carrying over 14.5 billion ton-miles annually).⁹⁰

ii. Through Rate Percentage Reduction

BNSF serves up a second mechanism to determine movement-specific SARR rates – its through rate percentage reduction approach. Under the Board's current percentage reduction approach, SARR revenues are reduced by an equal percentage so that total SARR revenues equals total SARR costs. Application of the Board's percentage reduction approach in the instant case produces a different percentage

⁸⁹ See BNSF Reply Narr. at III.H-6 to 8.

⁹⁰ See WFA/Basin Rebuttal electronic workpaper "LRR Route Miles Rebuttal.xls" for LRR route miles and "LRR Traffic and Revenues _ WFABasinRebuttal.xls" for system annual ton miles.

reduction in each year of the DCF period. For example, in 2005, the LRR percentage reduction (using RAM) equals 50.4%.⁹¹

Under BNSF's through rate percentage reduction approach, "when cross-over traffic is involved, the percentage reduction ... should be calculated by dividing the overage of SAC revenues minus SAC costs by the sum of through revenues for both local and cross-over traffic...."⁹² Application of BNSF's proposed through rate percentage reduction approach would reduce WFA/Basin's calculation of the 2005 LRR percentage reduction from 41.16 % (using standard percentage reduction) to 6.9%.

BNSF's through rate percentage reduction approach must be rejected because it violates the Guidelines. The Guidelines provide that if SARR revenues exceed SARR costs, SARR revenues must be reduced so they equal SARR costs. These SAC costs equal "the least cost at which an efficient competitor could provide the service."⁹³

BNSF's through movement percentage reduction method violates these basic SAC principles. Under BNSF's approach, SARR revenues are not reduced to equal SARR costs. For example, as shown in Rebuttal Table III-H-2, application of BNSF's percentage reduction approach would leave LRR revenues exceeding the LRR costs by \$112.8 million in 2005.

⁹¹ See WFA/Basin Rebuttal electronic workpaper "LRR RAM RATES_4Q 2004-2024 REBUTTAL.xls."

⁹² BNSF Reply Narr. at III.H-15.

⁹³ Guidelines, 1 I.C.C. 2d at 542.

Rebuttal Table III-H-2 Application of BNSF's Through Rate Percentage Reduction Procedure to LRR – 2005			
<u>LRR-SAC Revenues</u> (millions \$) (1)	LRR-SAC Revenue with BNSF through <u>Rate Reduction</u> (millions \$) (2)	<u>LRR-SAC Costs</u> (millions \$) (3)	<u>Difference</u> (millions \$) (Col. 2 - Col. 3)
\$329.3	\$306.5	\$193.7	\$112.8

BNSF claims its percentage reduction method conforms to the principle that percentage reduction maintains existing rate relationships.⁹⁴ As a practical matter, granting WFA/Basin the relief they seek in this case will have no impact on any BNSF rates other than the LRS rates. All of BNSF's other rates will remain unchanged. Only the LRS rates will be changed because they are unreasonably high.

Moreover, as is clear from the ICC and STB case rulings, the ICC and STB have sought to preserve the rate relationships within the SARR traffic group. BNSF's through rate percent-reduction method, like its avoidable cost method, finds no support in the Guidelines, the ICC and Board decisions implementing the Guidelines or SAC theory. It is just another one of BNSF's many proposals designed to gut the SAC test as a meaningful measure of rate reasonableness.

⁹⁴ See BNSF Reply Narr. at III.H-18.

4. **Maximum Rates**

a. **4Q04 Rates**

The maximum rates for BNSF service to LRS equal the greater of the stand-alone cost or the jurisdictional threshold. Table III-H-3 compares BNSF's 4Q04 rate levels (Column 2) to the 4Q04 jurisdictional threshold calculation (Column 4) and the 4Q04 stand-alone costs (calculating using RAM)(Column 5).

Rebuttal Table III-H-3 Summary of Maximum Rate Calculations for Issue Traffic in 4Q04					
<u>Origin</u> (1)	<u>BNSF Rate With Surcharge Per Ton</u> (2)	<u>BNSF Variable Cost Per Ton</u> (3)	<u>Jurisdictional Threshold Per Ton</u> (4)	<u>Stand-Alone Cost Per Ton</u> (5)	<u>Maximum Rate Per Ton</u> (6)
Dry Fork	\$6.71	\$1.45	\$2.61	\$3.37	\$3.37
Eagle Butte	6.72	1.50	2.70	3.37	3.37
Cordero	6.48	1.31	2.36	3.37	3.37
Caballo Rojo	6.53	1.31	2.36	3.37	3.37
Jacobs Ranch	6.25	1.24	2.23	3.37	3.37

WFA/Basin ask the Board to prescribe the maximum rates shown in Column 6 of Table III-H-3.⁹⁵

In its reply, BNSF asks the Board to depart from prior precedent and prescribe mine-specific maximum LRR SAC rates.⁹⁶ The Board should not do so. In all

⁹⁵ WFA/Basin also quantify relief under the Reduced Mark-Up Methodology and the Board's percentage reduction methodology. See WFA/Basin Rebuttal electronic workpaper "LRR Mark-Up Rate Reduction_Rebuttal.xls" and "Exhibit_III-H-1.xls."

⁹⁶ See BNSF Reply Narr. at III.H-28 to 31.

prior cases, the STB has prescribed a single SAC rate to apply to all PRB mine origins. BNSF argues that the Board should depart from this consistent precedent because of the differences in costs of providing service from different PRB mines. However, these asserted per ton cost differences are no different here than in other cases where the Board has prescribed a single SAC rate to apply to all PRB origins. BNSF also complains that use of an average SAC rate will reduce BNSF's revenue if WFA/Basin does not secure coal from southern PRB mines. Conversely, when WFA/Basin obtains coal from those locations, BNSF earns more revenue than it would using the average figure.

The BNSF normally publishes the same price to apply from all PRB mines.⁹⁷ This is true for both tariff pricing and contract pricing – {
}.⁹⁸ BNSF appears to be following a different course here because WFA owns the Dry Fork mine and BNSF wants to further punish WFA/Basin for instituting this suit by imposing the highest prices on Dry Fork-originated coal. The Board should see BNSF's pricing actions for what they are and rule accordingly.⁹⁹

⁹⁷ See e.g., BNSF Common Carrier Tariff 90068, WFA/Basin Rebuttal electronic workpaper "BNSF90068.pdf."

⁹⁸ See WFA/Basin Reply electronic workpaper "Contract 1_001.pdf" and "contract2_001.pdf."

⁹⁹ If the Board does decide to depart from prior precedent, WFA/Basin include mine-specific SAC cost computations in Rebuttal electronic workpaper "LRR RAM Rates_4Q 2004-2024 Rebuttal.xls."

Exhibit III-H-2

Redacted

Exhibit III-H-3

Redacted

Exhibit III-H-4

Redacted

EXHIBIT 2A

WFA/BASIN'S OPENING EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

ALLOCATION OF REVENUES FOR CROSS-OVER TRAFFIC

b. **Divisions – Existing Interchanges**

The LRR interchanges no traffic at existing BNSF interchanges.

c. **Divisions – Cross-Over Traffic**

WFA/Basin calculated cross-over revenue traffic revenue using established STB procedures. The first step in the STB-approved process is to calculate the BNSF line-haul revenues for the traffic moved by the LRR. See, e.g., Xcel I at 54-55. These calculations are set forth in WFA/Basin's electronic workpapers²² and briefly summarized below:

i. **Line-Haul Pricing Forecasts (4Q04 to 4Q05)**

BNSF maintains in the ordinary course of business plant-specific revenue forecasts by month for its projected PRB coal deliveries from October 2004 through December 2005. BNSF produced these forecasts in discovery and they are reproduced in WFA/Basin's workpapers.²³ WFA/Basin use these forecasts to calculate the revenues applicable to each individual LRR traffic movement for the 4Q04 through 4Q05 time period.²⁴

²² See electronic workpaper file "LRR Traffic and Revenues_WFABasin Opening.xls," sheets "SARR Traffic_2004" and "SARR Traffic_2005."

²³ See Workpapers Vol. 2, pp. 0951-1019.

²⁴ See Xcel I at 55 (accepting use of available plant-specific BNSF rate projections for project SARR traffic revenues). {

ii. **Line-Haul Pricing Forecasts for
Remaining Time Periods (1Q06 to 3Q24)**

For the periods after 2005, WFA/Basin utilize the following revenue projection procedures. If an LRR traffic movement was covered by a BNSF pricing document (i.e. a contract or pricing authority) that remained in effect after December 31, 2005, WFA/Basin calculate revenues through the end of the applicable pricing document term by forecasting the rates using the adjustment procedures in the involved pricing document.²⁵ After the expiration of the pricing document, WFA/Basin utilize EIA's AEO 2005 aggregate PRB rate forecasts to project movement revenues through 3Q24.²⁶ For movements where there was no BNSF pricing document in effect after December 31, 2005 (or the pricing document remained in effect but contained no adjustment procedures), WFA/Basin utilize the EIA AEO 2005 aggregate PRB rate forecasts to project revenues from 1Q06 through 3Q24. Finally, for two movements where the STB has prescribed maximum rates { } WFA/Basin apply the prescribed rates during the term of the prescription and, upon the expiration of the prescription, utilize the EIA AEO 2005 aggregate PRB rate forecasts to project revenues thereafter. Overall, the EIA projections utilized by WFA produce an average

} —

²⁵ See Xcel I at 55 (accepting use of similar procedures).

²⁶ Id.

revenue growth rate of 2.39% annually between 2005 and 2024.²⁷

iii. Line-Haul Divisions

The second step in the STB-approved process is to calculate the LRR's share, or division, of the total projected line-haul revenues for each cross-over movement. WFA/Basin calculate divisions for LRR cross-over traffic using the Modified Straight Mileage Prorate ("MSP") approach and the actual origin/destination route mileages included in BNSF's train movement records for the 1Q04-3Q04 time period.²⁸ "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 Block Prorate method ("Block Methodology"),²⁹ in its last nine SAC

²⁷ {

}

²⁸ These records were produced by BNSF in discovery and reproduced in WFA/Basin's workpapers. For the few origin/destination movements identified in BNSF's 4Q04/2005 traffic and revenue forecasts that do not appear in BNSF's 1Q04-3Q04 train movement records, the origin-to-destination routings are determined using, on a movement-by-movement basis, the predominant routes BNSF utilized for similar origin-to-destination movements shown in the BNSF 1Q04-3Q04 train movement records. See WFA/Basin electric workpaper file "LRR Traffic and Revenues_WFA Basin Opening.xls," sheets "Actual_Routing_2004," "SARR Traffic_2004" and "SARR Traffic_2005."

²⁹ "Under the Block Methodology, each carrier is assigned one 'block' for every 100 miles or part thereof that it carries the traffic, plus an additional block for originating or terminating the traffic; the total revenues are then allocated based on each carrier's share of the total number blocks." Xcel I at 17. MSP is a "refinement" of the Block Methodology. Xcel II at 8. "The only difference between the two approaches is that the lumps in the Block Methodology have been smoothed out." Duke/NS I at 24.

cases involving cross-over traffic.³⁰ These decisions include calculations of cross-over divisions on many of the same PRB traffic routings that WFA/Basin have included in the LRR. See Xcel I at 19, 44 (STB applies MSP method to calculate divisions for SARR-originated PRB traffic, including the LRR movement); TMPA at 31, 66 (STB applies the Block Methodology to calculate SARR divisions for SARR-originated PRB traffic, including traffic interchanged with the residual BNSF at Donkey Creek, Bridge Jct. and Moba Jct.).

Under MSP, the LRR divisions, on average, equal {

}³¹ As shown in Exhibits III-A-3

and III-A-4, these results conform to “the underlying 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”).

d. Other – Revenue Results

WFA/Basin’s application of the above-referenced procedures results in the LRR traffic revenues summarized in Table III-A-6:

³⁰ See McCarty Farms at 472; FMC at 31; WPL I at 24; PPL at 11; TMPA 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.

³¹ See electronic workpaper file “LRR Traffic and Revenues_WFABasin Opening.xls” sheet “SARR Traffic_2005.”

Table III-A-6 <u>LRR System Revenues</u>	
<u>Period</u>	<u>Revenues (Millions)</u>
4Q 2004	\$ 76.6
2005	327.1
2006	334.1
2007	341.5
2008	349.4
2009	363.1
2010	370.8
2011	379.7
2012	388.5
2013	396.7
2014	404.4
2015	413.5
2016	421.1
2017	429.4
2018	439.1
2019	453.1
2020	463.2
2021	474.0
2022	486.9
2023	502.7
1Q-3Q 2024	389.1

EXHIBIT
III-A-2
REDACTED

LRR DIVISIONS ANALYSES UNDER
REAL WORLD STANDARDS

The Board's SAC test is premised on a few bedrock principles. One such principle, repeatedly cited and emphasized by the Board throughout its SAC decisions, is that "the assumptions used in the SAC analysis ... must be realistic, i.e., consistent with the underlying realities of real-world railroading." Xcel II at 12. WFA/Basin asked Mr. David Weishaar to conduct three analyses under the Board's "real-world" test.

WFA/Basin first asked Mr. Weishaar to review its LRR/BNSF divisions results against real-world railroading standards. WFA/Basin next asked Mr. Weishaar to address the issue of whether divisions methods sponsored by railroads in some recent STB rate cases comport with real-world divisions standards. Finally, WFA/Basin asked Mr. Weishaar to address the Board's discussion of real-world divisions in the Duke/NS I decision.

Mr. Weishaar is uniquely well qualified to perform these analyses. Immediately prior to his retirement, Mr. Weishaar was the chief coal marketing officer for the former Chicago and North Western Railway Company ("CNW") and its wholly-owned subsidiary, Western Railroad Properties, Inc. ("WRPI"). While at CNW and WRPI, Mr. Weishaar negotiated division and allowance agreements for movements of coal as well as steel scrap iron, and other commodities. Mr. Weishaar's WRPI experience

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Exhibit III-A-3
(Page 2 of 10)

is particularly pertinent here.

Mr. Weishaar observes the LRR is the mirror image of WRPI. WRPI was a new entrant into the PRB market – just like the LRR. WRPI began its PRB operations in 1984 and continued to originate PRB coal until it was acquired by UP in 1995. WRPI served most of the same PRB mines the LRR will serve. And, like the LRR, it served as a short feeder line connecting PRB mines to a major western carrier – in WRPI's case, the Union Pacific Railroad Company ("UP").

CNW/WRPI, like the LRR, had to negotiate a divisions agreement with its one and only PRB rail connection. Mr. Weishaar was personally involved in these divisions negotiations and is intimately familiar with the resulting divisions agreements.

I.
LRR DIVISIONS

Under the MSP approach, the LRR's average divisions in 2005 approximate

As shown in

Table I below, the LRR's divisions also approximate, on average, about 7.5 percentage points above straight mileage pro-rate divisions.

Table I Average LRR Divisions		
Average LRR Miles As Percentage of Total LRR/BNSF Miles (1)	Average LRR Divisions As Percentage of Total LRR/BNSF Revenue (2)	Difference (Column (2) - Column (1)) % Point (3)
7.0%	14.5%	7.5% Points

Mr. Weishaar finds that the divisions set by the MSP approach produce results that he would expect the LRR to negotiate with the residual BNSF. He cites three real-world comparables: the actual WRPI/UP divisions arrangements; standard industry practice; and BNSF divisions data produced in discovery in this case.

1. WRPI/UP Divisions

Mr. Weishaar believes the best real-world comparable to judge the LRR/BNSF divisions are the former WRPI/UP divisions. These situations are very similar because:

- Both the LRR and CNW/WRPI were new entrants into the PRB.
- CNW/WRPI entered the PRB to compete with BNSF. LRR would enter the PRB to compete with UP.
- To effectively compete against BNSF, CNW/WRPI had to align itself with a major carrier – UP. Similarly, for the LRR to effectively compete against UP, it would have to align itself with BNSF.
- The UP had a tremendous financial incentive to align itself with CNW/WRPI because of its critical access to highly lucrative PRB coal traffic. This interest gave CNW/WRPI leverage in divisions negotiations. BNSF, too, would have the same financial incentive to align itself with the LRR, which would give LRR leverage in divisions discussions.

- WRPI was a short-haul originating carrier (average haul 185 miles) that incurred terminal costs in originating and interchanging unit trains with UP. The LRR also is a short-haul carrier (average haul 67.6 miles) that incurs terminal costs in originating and interchanging coal trains with BNSF.
- WRPI handled only unit coal trains and its lines extended from the PRB to South Morrill, NE. LRR also handles only unit coal trains and its lines extend from the PRB to Guernsey, WY.¹
- On almost all WRPI/UP hauls, WRPI carried the coal for less than 25% of the haul. The same holds true for the LRR.

LRR's average division exceeds mileage prorata divisions by 7.5 percentage points. Mr. Weishaar reports that WRPI's divisions agreements with UP typically provided WRPI a higher mark-up over straight mileage prorate divisions than 7.5 percentage points.²

Mr. Weishaar also points to data WRPI publically released in the early 1990's showing that WRPI's divisions at that time approximated 16.3 mills per ton mile.³

¹ A map comparing the WRPI route and LRS route is appended at page 10 of this Exhibit III-A-3.

² Continuing confidentiality restrictions prevent Mr. Weishaar from disclosing movement-specific WRPI/UP revenue divisions.

³ See WFA/Basin electronic workpaper file "WRPI 1990 Mills Per Ton Mile.xls."

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Exhibit III-A-3
(Page 5 of 10)

Mr. Weishaar notes that he would expect LRR's divisions than WRPI's divisions because LRR's average length of haul (67.6 miles) is less than half WRPI's average length of haul (approximately 185 miles).⁴

2. Standard Industry Practice

Mr. Weishaar explains that it is standard practice in the rail industry for a short-haul originating carrier to earn a division that substantially exceeds a straight mileage prorate allocation. For example, Mr. Weishaar observes that CNW served as a bridge and destination-carrier for steel movements originated at plants of U.S. Steel served by the Elgin, Joliet & Eastern Railway Company ("EJ&E"). Mr. Weishaar recalls that the EJ&E's hauls were very short (less than 25 miles), yet the EJ&E commanded a substantial premium that was highly disproportionate to the length of its haul.

Mr. Weishaar also points to the written testimony of Richard B. Peterson in the FMC case. Mr. Peterson at the time he submitted his testimony in the FMC case was UP's Service Director – Interline Marketing. Mr. Peterson testified that short haul carriers usually earn divisions that substantially exceed both mileage prorate divisions and divisions set using the STB's Block Methodology:

⁴ The 185-mile average haul was used by WRPI/CNW management to determine WRPI's revenue per ton-mile for its coal movements.

It is clear that for moves where one railroad receives a short haul and performs terminal services, standard divisions are well above a mileage pro-rate, and also substantially above the ... mileage-block method.

FMC Corp. v. Union Pacific R.R., UP's Reply Evidence, Verified Statement of Richard B. Peterson at 19 (filed March 31, 1999) (emphasis added).⁵

3. Divisions Data In This Case

BNSF provided actual divisions data in discovery. As shown in WFA/Basin's Exhibit-III-A-4 that data shows numerous examples where BNSF, or its interline partners, received divisions on coal traffic that significantly exceed divisions calculated using a straight mileage prorate.

II.
OTHER STANDARDS

In recent STB cases, railroad defendants have argued that the Board should set divisions in SAC cases using the so-called Density Adjusted Revenue Allocation ("DARA") formula and/or a "modified" MSP procedure. Mr. Weishaar finds that neither approach comports with actual method railroads use to set divisions in the real world.

The STB described the DARA formula in its Xcel II decision, as follows:

Under DARA, BNSF would first
calculate the variable costs associated with each

⁵ See WFA/Basin electronic workpaper file "III-A-Peterson WP."

part of the movement and assign revenues to cover those costs. The remaining revenue from the movement – the contribution to fixed costs – would be allocated between the on-SARR and off-SARR part of the movement based on a formula that assigns a greater share to the part with the longer distance and to the part using lighter density lines.

Id. at 8 (footnote omitted). Mr. Weishaar reports that in his 25+ years as a railroad executive he never once saw, or heard of, interline divisions set using the DARA procedure, or any other procedures which, like DARA, use line “density” as a divisions metric.

In the recent Otter Tail case, BNSF advocated altering the MSP divisions methodology. Under BNSF’s proposed “modified” MSP, the 100-mile origin and destination blocks used in MSP are reduced to 25-mile blocks for PRB traffic originated in shipper cars.⁶ BNSF purported to use an application the Board’s URCS costing formula to support its approach. Mr. Weishaar reports that he has never seen, or heard of, interline divisions being set using an agreed-upon application of URCS, or any other ICC/STB formula.

Application of BNSF’s modified MSP here would reduce the LRR’s average revenue to its mileage prorate revenues plus about 2.1 percentage points.⁷ Mr.

⁶ See Otter Tail Power Co. v. Burlington Northern and Santa Fe Ry., BNSF Supp. Reply Evidence at I-18 n. 30 (Dated March 22, 2004).

⁷ See WFA/Basin electric workpaper file “MSPComp_25mil_straight.xls.”

Weishaar emphasizes that if WRPI's divisions had been similarly capped, it would have been financially impossible for CNW/WRPI to enter into the PRB market. Mr. Weishaar vividly recalls that WRPI's financial survival was tied to earning substantial premiums over straight mileage prorate divisions. Limiting CNW/WRPI's division to a straight mileage addition of only 2.1 percentage points would have doomed WRPI from the outset as a viable going concern.

III. DUKE/NS CASE

In the Board's Duke/NS I decision, the Board concluded that SAC divisions should be set using "the defendant carrier's relative costs of providing service over the two segments." Duke/NS I at 20. Mr. Weishaar notes this standard, like DARA and the modified MSP standard, is not used in the real world. For example, CNW/WRPI and UP did not set WRPI divisions based upon "relative costs" of providing service.

Mr. Weishaar also observes that in Duke/NS I, the Board appears to have concluded – based on hypothetical examples – that in real-world situations where two carriers serve a mine, and one is a short-haul carrier, the short-haul carrier could never negotiate a reasonable real-world revenue division. Mr. Weishaar observes that if the Board was right, WRPI would never have come into existence.

Mr. Weishaar observes that the Board's hypothetical analysis in Duke/NS I is seriously flawed when measured against real-world realities. The Board's hypothetical,

as Mr. Weishaar understands it, appears to assume that all SARR traffic (other than the complaining shipper's) is so-called bottleneck traffic where two carriers (the SARR and the second carrier) serve the traffic origin but only the residual defendant carrier serves the destination. Under this scenario, the Board concluded that the residual carrier, as a bottleneck carrier, will be able to unfairly force the SARR to accept very low divisions.

Mr. Weishaar notes that the Board cites no real-world divisions data to support its conclusions. Mr. Weishaar also observes that whatever validity the hypothetical may have had in the Duke/NS case, it bares no correlation whatsoever to the LRR movements from the PRB. Mr. Weishaar notes that while some LRR movements are LRR/residual BNSF moves to BNSF-captive plants, there are many others that are not, including movements to competitively served plants, movements to competitively served interchanges and rail/water transfer points, movements to plants that are captive to other carriers, movements to plants that are captive to UP, and movements from LRR-captive northern PRB mines.

Mr. Weishaar observes that WRPI's real-world coal traffic movements were very similar to the LRR's in that they both involved PRB origin service to a single connecting carrier which in turn transported coal to a variety of plants (captive, competitive, etc.) and interchanges. WRPI did negotiate fair marketplace divisions and for the reasons Mr. Weishaar previously discussed, the LRR would be able to do the same. Mr. Weishaar concludes that the Board's theoretical divisions analysis in Duke/NS I does not apply to the LRR transportation facts and circumstances.

Schematic of the WRPI Railroad and the Laramie River Railroad

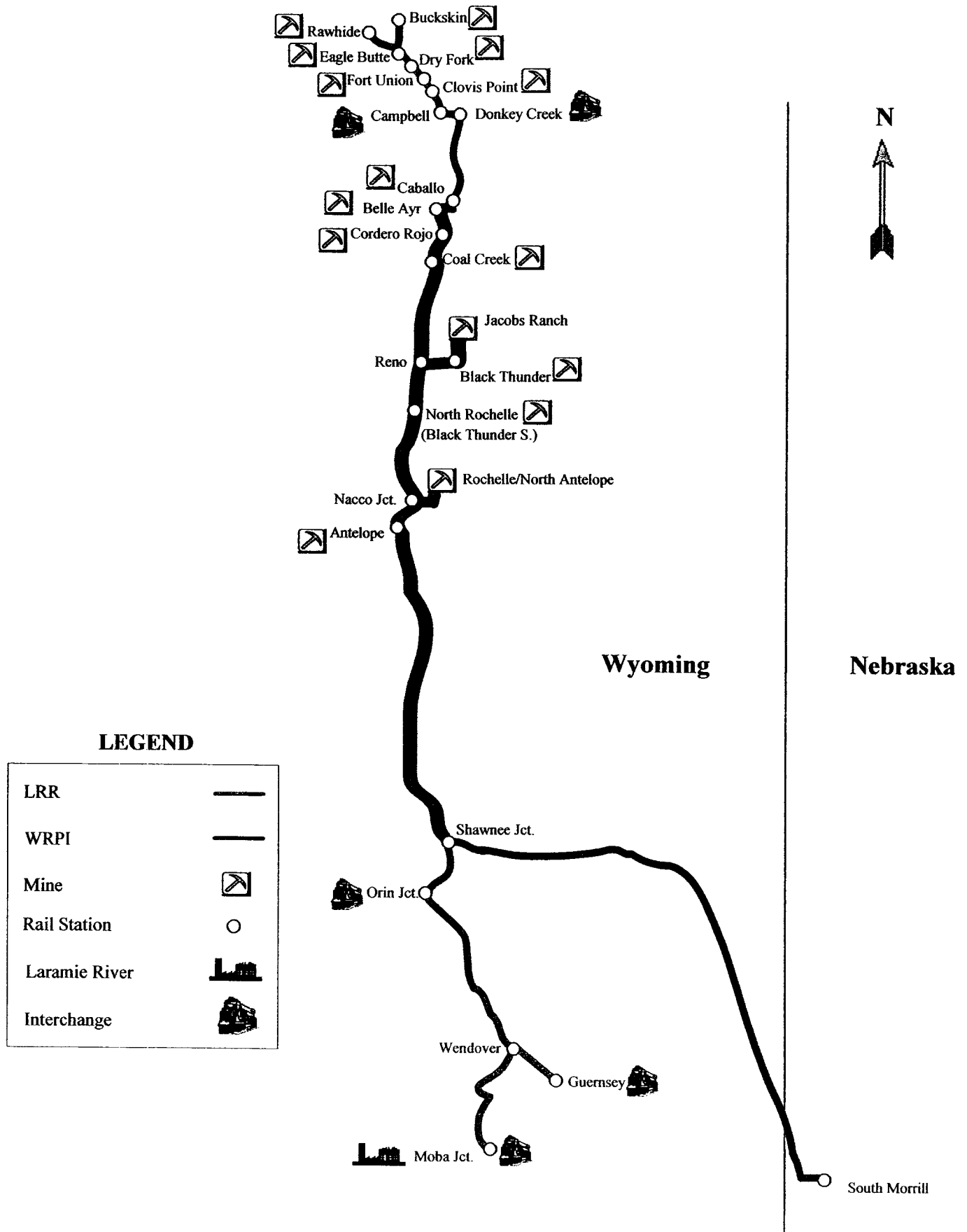


EXHIBIT
III-A-4
REDACTED

EXHIBIT 2B

WFA/BASIN'S REBUTTAL EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

ALLOCATION OF REVENUES FOR CROSS-OVER TRAFFIC

then observes that the RCAF-U increased by 7.02% in 2004.⁷¹ BNSF's "comparison" is obviously flawed. The proper comparison is between BNSF's correct fuel price increase in 2004 versus increases in the fuel price component in the RCAF-U. In 2004, BNSF's system-average fuel price increased by { }.⁷² The fuel component in the RCAF-U increased by { }.⁷³

In addition, as shown in Rebuttal Exhibit III-A-3, BNSF's proposed fuel surcharge mechanism vastly overstates BNSF's actual projected fuel cost increases. For example, in 4Q04, WFA/Basin paid fuel surcharges of 0.62 per ton. A cost-based fuel surcharge equals only \$0.11 per ton.

b. Divisions – Existing Interchanges

The parties agree that the LRR interchanges no traffic at existing BNSF interchanges.

c. Divisions – Cross-Over Traffic

The first step in the STB-approved process to calculate SARR cross-over traffic divisions is to identify the total line-haul rates the SARR and the incumbent carrier would divide. In their opening evidence, WFA/Basin calculated line-haul divisions using

⁷¹ Id.

⁷² See WFA/Basin Rebuttal electronic workpaper "BNSF Fuel Price Relative to HDF Costs.xls."

⁷³ Id.

the MSP procedures the Board approved in Xcel and other recent cases.⁷⁴ BNSF projects line-haul revenues from cross-over traffic using two approaches: an “adjusted MSP” approach and an “avoided cost” approach.⁷⁵ Each is discussed below.

i. **Line-Haul Pricing Forecasts – MSP**

BNSF’s “adjusted MSP” approach accepts WFA/Basin’s MSP line-haul pricing forecasts, and forecasting procedures, over the 20 year DCF period, except as follows:

(a) **Prescribed Rate Forecasts**

WFA/Basin’s traffic group includes two shippers { } that transport traffic under STB-prescribed rates. WFA/Basin utilized the Board’s prescribed rates during the term of the rate prescriptions to forecast LRR revenues on the involved movements.⁷⁶ BNSF accepts this approach, but updates the prescribed rates to reflect Board-ordered changes in these prescriptions.⁷⁷ WFA/Basin accept the changes and include them in their Rebuttal LRR revenue calculations.⁷⁸

⁷⁴ See WFA Op. Narr. at III-A-15.

⁷⁵ See BNSF Reply Narr. at III.A-49 to 57.

⁷⁶ See WFA/Basin Op. Narr. at III-A-16.

⁷⁷ See BNSF Reply Narr. at III.A-59.

⁷⁸ Revised rates to {
_____ } Revised rates to {
_____ }.

(b) Contract Rate Forecasts

WFA/Basin's traffic group also includes shippers that are currently transporting coal under contracts with BNSF. WFA/Basin forecast contract rates, over the term of the contract, using the contract rate adjustment procedures.⁷⁹ Some of these contract adjustment procedures incorporate changes in the RCAF-U and RCAF-A. Consistent with Board precedent, WFA/Basin utilized forecasts prepared by Global Insight to project changes in these RCAF indices.⁸⁰ On Reply, BNSF accepts this approach but substitutes the March 2005 Global Insight forecast for the December 2004 Global Insight Forecast used by WFA/Basin.⁸¹ On Rebuttal, WFA/Basin utilize Global Insight's June 2005 RCAF forecasts, which were issued after the filing of BNSF's Reply.

(c) Revenue Forecasts During 2006 to 2009

In the absence of a controlling BNSF pricing document adjustment procedure, WFA/Basin forecast revenues utilizing the AEO 2005.⁸² BNSF also relies upon the AEO 2005 to project corresponding revenues after 2009. However, for the 2006

⁷⁹ See WFA/Basin Op. Narr. at III-A-16.

⁸⁰ See WFA/Basin Op. electronic workpaper "Exhibit_III-H-1.xls."

⁸¹ See BNSF Reply electronic workpaper "LRR Traffic and Revenues_WFABasinOpen_BNSF Revised.xls."

⁸² See WFA/Basin Op. Narr. at III-A-16.

to 2009 time period, BNSF substitutes internal system-wide BNSF coal price forecasts contained in its Long Range Plan.⁸³

WFA/Basin's approach complies with the Board's Xcel rulings. BNSF's approach does not – and was specifically rejected in Xcel.⁸⁴ The Board should similarly reject BNSF's approach in the instant case for the same reasons the Board rejected it in Xcel.

- BNSF's Long Range Plan, like the BNSF "MACRO" forecast in Xcel, forecasts changes in BNSF's system-wide coal traffic, not just BNSF's PRB coal traffic. The AEO 2005 is superior because it applies to PRB coal traffic – i.e. the traffic included in the LRR traffic group.⁸⁵

- BNSF's Long Range Plan forecasts revenue growth using a fixed annual percentage increase of { }. Neither the Long Range Plan, nor BNSF on Reply, provides any basis or support for this figure. In contrast, the AEO 2005 projections are fully supported and specifically designed to forecast price changes in PRB coal traffic.⁸⁶

- The AEO 2005, unlike BNSF's Long Range Plan, was prepared by a neutral third party (the EIA). As the Board observed in Xcel I, "forecasts developed by

⁸³ See BNSF Reply Narr. at III.A-59 to 61.

⁸⁴ See Xcel I at 55.

⁸⁵ See Xcel II at 15.

⁸⁶ See Xcel I at 55 (EIA forecasts PRB rate changes).

EIA are more reliable and less subject to manipulation by litigants than forecasts by private parties.” Xcel I at 55.

- Consistent with Board precedent, WFA/Basin have projected coal volumes during the 2006-2009 period using the AEO 2005 PRB projections. Applying the corresponding AEO 2005 revenue forecasts produces internally consistent forecasting results.⁸⁷

(d) Fuel Surcharge Projections

BNSF has published a tariff containing a fuel surcharge on coal traffic. This surcharge is set forth in Item 3380 of BNSF’s Rules Book, 6100-A. The fuel surcharge is pegged to changes in the average price of Retail On-Highway Diesel Fuel, as calculated by EIA. The pricing documents applicable to some members of the LRR traffic group include BNSF’s fuel surcharge tariff.⁸⁸

In their opening evidence, WFA/Basin calculated fuel surcharge revenues using actual tariff surcharges through 1Q2005.⁸⁹ WFA/Basin projected post-1Q2005 fuel surcharges using EIA’s most recent forecast of diesel fuel price changes. In its reply

⁸⁷ Id. (“where EIA tonnage forecasts are used it is preferable to use matching EIA rate forecasts as well. This provides a single, consistent, and independent source for the coal rate and tonnage projections.”)

⁸⁸ BNSF’s tariff surcharge is applicable to coal moving to {
 }.

⁸⁹ See WFA/Basin Op. electronic workpaper “LRR Traffic and Revenues_WFABasin Opening.xls.”

evidence, BNSF updates WFA/Basin's forecast by including actual 2Q2005 surcharges.⁹⁰ WFA/Basin accept this update and make three additional changes as well: WFA/Basin correct their Opening surcharge calculations to reflect the two-month lag in the Retail On-Highway Diesel Fuel price average used to calculate the fuel surcharge rate; WFA/Basin update fuel surcharge calculations to reflect the actual fuel surcharge percentages through October 2005 (the latest period available); and WFA/Basin assume the November and December 2005 fuel surcharge percentages will equal the October 2005 fuel surcharge percentage.⁹¹

For surcharge periods after 2Q2005, BNSF does not utilize the EIA diesel fuel price forecast. Instead, BNSF utilizes an index it calls the "RCAF Fuel" forecast.⁹² WFA/Basin's projections using EIA diesel fuel price forecasts are clearly superior to BNSF's RCAF Fuel forecast for two reasons.

First, the EIA diesel fuel (distillate) index has historically better tracked the actual changes in the Retail On-Highway Diesel Fuel price index BNSF utilizes to calculate its fuel surcharge. As shown on Page 1 of Rebuttal Exhibit III-A-4, the annual-percent change in EIA's historic diesel fuel (distillate) price index has moved in virtual

⁹⁰ See BNSF Reply Narr. at III.A-61.

⁹¹ The reason for this assumption is due to the 2005 SARR rates being calculated on an annual basis and not a monthly basis as is BNSF's real-world fuel surcharge. See WFA/Basin Rebuttal electronic workpaper "LRR Traffic and Revenue_WFABasinRebuttal.xls."

⁹² See BNSF Reply Narr. at III.A-61.

lock-step with the change in Retail On-Highway Diesel Fuel prices. In contrast, while the BNSF's RCAF Fuel index has moved in a vaguely similar pattern to the Retail On-Highway Diesel Fuel prices, it has not mirrored the change as well as the EIA's historic diesel fuel (distillate) price index. See Exhibit III-A-4, p. 2. Second, the EIA's forecast is an unbiased forecast of future diesel fuel (distillate) prices by a neutral third party. BNSF's made-for-litigation forecast is not.

ii. **Line-Haul Price Forecasts – Avoidable Cost**

BNSF serves up a second method to forecast LRR revenues. Under BNSF's alternative approach, revenues on the on-SARR segment of LRR cross-over movements are set at BNSF's avoidable costs, and adjusted by the RCAF-A.⁹³ As discussed in detail below, BNSF's avoidable cost method is dead-on-arrival.

iii. **Line-Haul Divisions**

Once line-haul rates are identified, the second step in the STB-approved revenue process is to calculate the LRR's division of the total projected line-haul revenue for each cross-over movement. WFA/Basin utilized the Board's MSP procedure to calculate divisions on LRR cross-over traffic. As WFA/Basin explained in detail in their opening evidence, the Board has used this MSP method, or its predecessor the Block Methodology, to set SARR divisions in its last nine SAC cases involving cross-over

⁹³ See BNSF Reply Narr. at III.A-49 to 50.

traffic.⁹⁴ BNSF's reply evidence contains a long-winded, repetitive and vituperative attack on WFA/Basin's use of the Board-approved MSP approach.⁹⁵ As discussed below, none of BNSF's challenges has any merit. On Rebuttal, WFA/Basin continue to set LRR divisions on cross-over traffic using MSP.

(a) Burden of Proof

BNSF argues that WFA/Basin failed to demonstrate that MSP is a valid means of setting divisions on cross-over traffic. BNSF is wrong. The Board, and the ICC before it, have consistently used MSP, or its predecessor, the MMP methodology, to set cross-over divisions in all SAC cases since 1994.⁹⁶ These cases have included several cases involving SARRs which, like the LRR, originate PRB cross-over traffic.⁹⁷

As the Board observed in PPL, if a party challenges use of the established method for establishing SARR divisions, the burden is on the party making the challenge to demonstrate that the method should not be employed in the particular case.

The modified mileage proration process is an accepted and widely used tool for apportioning revenues between carriers. But if that procedure is not appropriate to use in a particular case, the parties to that case can let us

⁹⁴ See WFA/Basin Op. Narr. at III-A-18 n.30.

⁹⁵ See BNSF Reply Narr. at III.A-30 to 35.

⁹⁶ See McCarty Farms at 472; FMC at 31; Duke/NS I at 25; CPL at 21; Duke/CSX at 22; Xcel I at 17-19; and Xcel II at 11.

⁹⁷ See WPL at 24; TMPA at 31; Xcel I at 17-19.

know, and we will use whatever is the most appropriate procedure for apportioning revenues for that case.

PPL (STB decision served Nov. 27, 2001) at 6 n.18.

The Board reaffirmed the PPL rule in Xcel. As stated recently by Board counsel:

In [the Xcel] proceeding, while Xcel asked the Board to follow precedent by using the MSP method of allocating revenues from cross-over traffic, BNSF criticized MSP BNSF argued [for an] alternative method.... The burden was on BNSF to make a convincing showing that its alternative approach was superior to the general approach the agency had used since 1994, as there is a "norm of regularity" in government conduct that presumes an agency's duties are "best carried out if the settled rule is adhered to."

Board's Xcel Brief at 52.

Thus, the burden falls on BNSF to demonstrate that MSP is "not appropriate"⁹⁸ for use in this case.⁹⁹

⁹⁸ See PPL at 6 n.18.

⁹⁹ Also, on opening, WFA/Basin introduced substantial "real world" market and cost evidence – which stands unrebutted – demonstrating that MSP provides a conservative estimate of the LRR's divisions. See WFA/Basin Op. Narr. at III-A-18, Op. Exhibit III-A-3 and Op. Exhibit III-A-4.

(b) Avoidable Cost Divisions

BNSF's principal attack on MSP is a theoretical one. BNSF claims that MSP is not an appropriate method to set divisions on cross-over traffic because the results are inconsistent with "contestability" theory.¹⁰⁰ According to BNSF, "contestability theory" holds that a SARR should be seen as a competitor to the incumbent railroad – i.e., both serve the same market and both compete with each other. Under this contestability scenario, BNSF posits that a SARR, and the incumbent, would compete for the LRR customers by "shouting out" rate offers until BNSF shouted out its final offer – providing the service at its avoidable costs. The final offer, under BNSF's theory, sets the SARR's division.¹⁰¹

BNSF calculates "avoidable costs" as equaling BNSF's URCS variable costs for providing the service.¹⁰² For example, for an LRR traffic movement between the Cordero Mine and Guernsey, BNSF would set the LRR division to equal BNSF's URCS variable cost for providing this service.

The STB, and the ICC before it, have consistently rejected carrier-sponsored proposals to set SARR divisions at "avoidable cost" or other levels generally

¹⁰⁰ See BNSF Reply Narr. at III.A-35 to 45.

¹⁰¹ Id.

¹⁰² Id. at III.A-50.

equal to, or near, the incumbent carrier's URCS costs.¹⁰³ BNSF is forced to admit that its avoidable cost divisions proposal has been "rejected" in prior cases, but asks the Board to reconsider these rulings.¹⁰⁴ BNSF's assorted arguments – which focus on the ICC's Nevada Power decision – provide no rational basis for overruling Nevada Power and its progeny.

First, BNSF argues that the ICC and the STB have misapplied contestability theory in consistently holding that a SARR should be viewed as a replacement for – not a competitor of – the incumbent carrier over a SARR system.¹⁰⁵

The ICC, and the STB, have not misapplied contestability theory – BNSF has. Under BNSF's application of contestability theory, the new entrant SARR must beat a price for cross-over traffic predicated upon the incumbent's expected competitive response to the new entrant's price. This result turns contestability theory upside down.

¹⁰³ See, e.g., Nevada Power I, 6 I.C.C.2d at 45-46; McCarty Farms, 2 S.T.B. at 472; Duke/NS I at 19.

¹⁰⁴ See BNSF Reply Narr. at III.A-46.

¹⁰⁵ See Nevada Power II, 10 I.C.C.2d at 267 ("we view the entrant as if it were a replacement for that segment of the rail system whose services the entrant would be offering"); accord AEPCO (STB served Aug. 20, 2002) at 6 n.9 ("contestable market theory allows for the simulation of a competitive price by calculating what a hypothesized efficient producer would need to change to provide replacement service"); McCarty Farms, 2 S.T.B. at 472 ("[a]s the ICC explained at some length in Nevada Power II... it would be inconsistent with the nature and purpose of a SAC analysis to treat the SARR as a competitor of the incumbent railroad rather than its replacement"); WTU, 1 S.T.B. at 670 (a SARR is "a replacement carrier that steps into the shoes of the incumbent carrier for the segment of the rail system that the SARR would serve").

Contestability theory is predicated upon potential entrants evaluating "the profitability of entry at the incumbent firms' pre-entry prices" without "fear of retaliatory price alterations" by the incumbent.

A contestable market is one in which the positions of incumbents are easily contested by entrants. In brief, a perfectly contestable economic market is defined to be one into which entry is completely free, from which exit is costless, in which entrants and incumbents compete on completely symmetric terms, and entry is not impeded by fear of retaliatory price alterations.

* * *

the potential entrants evaluate the profitability of entry at the incumbent firms' pre-entry prices. That is, although the potential entrants recognize that an expansion of industry outputs leads to lower prices – in accord with the market demand curves – the entrants nevertheless assume that if they undercut incumbents' prices they can sell as much of the corresponding good as the quantity demanded by the market at their own prices.

Baumol, Danzar and Willig, Contestable Market 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”).

Similarly, as noted by another scholar:

The results of contestability theory require not only that rapid entry and exit be possible, but that potential entrants make their decisions taking the market price as given. This definition defines sustainability in terms of entrant profitability given the number of incumbents, their output, and the price at which that output clears the market. Under this definition of sustainability, the entrant is not permitted to take account of the price reduction that its own output will produce when it assesses the profitability of entry. The entrant is not permitted to take account of possible reactions of incumbents. Hit-and-run entry is supposed to occur if the potential entrant could make a profit at the pre-entry price. If the potential entrant comes into the market only if it could make a profit at the expected post-entry price, hit-and-run entry is much less plausible.

S. Martin, The Theory of Contestable Markets at 10 (July 2000) (footnote omitted) (see WFA/Basin electronic workpaper “Theoryofcontestablemarkets.pdf”).

Thus, under basic principles of contestability theory, the new entrant is not a competitor of the incumbent for the business it solicits – it replaces the incumbent for that business. Otherwise, the new entrant could not evaluate “the profitability of entry at

the incumbent firm's pre-entry prices."¹⁰⁶ And the new entrant would not set its own prices without "fear of retaliatory price alterations" by the incumbent.¹⁰⁷

The ICC recognized, and applied, these fundamental contestability principles in Nevada Power. In Nevada Power, the defendant carrier (UP) argued that a SARR should be viewed as a competitor of the incumbent for the SARR's traffic.¹⁰⁸ UP further argued that the resulting competition would result in SAC divisions that approximated UP's variable service costs.¹⁰⁹ Nevada Power, on the other hand, argued that its SARR was "a replacement for those lines of the incumbent carriers that are replicated" and that the SARR should earn the divisions the replacement SARR and the residual UP would negotiate in the marketplace.¹¹⁰

After carefully reviewing the Guidelines, and contestability theory, the ICC correctly held that the SARR must be viewed as a replacement for the incumbent carrier on the lines over which the SARR provides service, not a competitor. In so holding, the

¹⁰⁶ See Constable Markets at 5.

¹⁰⁷ Id. at 349.

¹⁰⁸ See Nevada Power II, 10 I.C.C.2d at 265.

¹⁰⁹ Id. at 266.

¹¹⁰ Id. at 265.

ICC correctly stated that “we cannot take account of any post-entry responses by the incumbents.”¹¹¹ This clearly accords with contestable market theory.¹¹²

The ICC also held that UP’s competition construct “would perpetuate UP’s hold over this captive market because ... a potential entrant will shun a market when price retaliation by the incumbent reduces revenue before the entrant has a chance to recoup its costs.” Id. at 266 (internal quotation marks omitted). This conclusion is also consistent with the basic precepts of contestability theory. See Contestable Markets at 349 (entry into a contestable market “is not impeded by fear of retaliatory price alterations”).¹¹³

¹¹¹ Id. at 267.

¹¹² See Contestable Markets at 5 (“potential entrants evaluate the profitability of entry of the market firms’ pre-entry prices”).

¹¹³ Similarly, the STB has observed:

Contestable market theory would allow instantaneous exit and reentry. However, our SAC constraint does not assume such immediate exit and reentry activity for the SAC carrier. Rather, it judges the financial decision to enter the market by the final outcome at the end of the forecasted SAC period (in this case, 20 years). The purpose of this hypothetical exercise is to determine if the SAC carrier could provide the service over the course of the forecasted SAC period at rates below those charged by the defendants.

Ashley Creek Phosphate Co. v. Chevron Pipe Line Co., STB No. 40131 (Sub-No. 1) (STB Issued Oct. 30, 1996) at 1996 WL 625471, *20 n.36.

Following its Nevada Power ruling, the ICC, and the Board, have consistently and correctly held that a SARR must be viewed as a replacement for, not a competitor of, the incumbent. See McCarty Farms 2 S.T.B. at 472; WTU 1 S.T.B. at 670; AEPCO at 2. BNSF's contention that a SARR should be viewed as a competitor of, not a replacement for, the incumbent, with resulting divisions set at levels equal to the incumbent's variable costs, finds no support whatsoever in contestability theory as properly construed and applied by the ICC and the Board in prior cases.

Second, BNSF argues that the Board may wish to revisit Nevada Power because "[i]t is reasonable to assume that at the time it rendered Nevada Power, the ICC did not anticipate that shippers would make such extensive use of cross-over traffic."¹¹⁴ BNSF's contentions here are belied by the facts in Nevada Power, where cross-over traffic dominated the SARR. See Nevada Power II at 265 ("cross-over traffic represents approximately 60% of the traffic in the [Nevada Power SARR]").

In addition, the STB has repeatedly reaffirmed Nevada Power II, most recently in its March 15, 2005 decision in AEPCO (*id.* at 2 (SARR is an "efficient replacement carrier")) and repeatedly reaffirmed the propriety of using cross-over traffic in

¹¹⁴ See BNSF Reply Narr at III.A-46.

SARR modeling.¹¹⁵ Thus, there are no pertinent case-specific developments since Nevada Power II that require the Board to revisit its decision.¹¹⁶

Third, BNSF argues that the Board should revisit Nevada Power II because UP did not appeal the Nevada Power II decision. BNSF's reply states in pertinent part:

because Union Pacific prevailed in the *Nevada Power* proceeding, it had no opportunity to appeal the ICC's decision that (1) permitted cross-over traffic, (2) employed a modified mileage prorate in estimating divisions on cross-over traffic, and (3) rejected Union Pacific's testimony on the application of contestability principles as the basis for establishing revenue divisions on cross-over traffic.

BNSF Reply Narr. at III.A-46.

UP did not appeal Nevada Power II, but UP has had the opportunity to address SARR cross-over traffic revenue divisions issues in two post-Nevada Power II cases – FMC and WPL. In WPL UP accepted, without contention, the use of the Board's MMP methodology to set SARR divisions.¹¹⁷ And in FMC, UP asked the Board to apply a modified MMP methodology that provided increased divisions for short-haul movements from those calculated under the MMP methodology or MSP.¹¹⁸

¹¹⁵ See, e.g. Xcel I at 16-17.

¹¹⁶ Id.

¹¹⁷ See WPL I at 24.

¹¹⁸ See FMC at 30-31. In Nevada Power II UP urged the ICC to set cross-over divisions using an "efficient component pricing rule." Id. at 266. The ICC subsequently,

Fourth, BNSF maintains the ICC was wrong in concluding that setting SARR divisions at the incumbent's variable costs for the service "would not permit a SARR to recover its fixed costs."¹¹⁹ BNSF's argument is absurd. UP candidly "admitt[ed]" in Nevada Power that setting SARR divisions at the incumbent's variable costs "would allow for only a minimal contribution to [the Nevada Power SARR's] joint and common costs." Nevada Power II, 10 I.C.C.2d at 266. The same is true in this case. By definition, variable costs do not include any contribution to fixed costs.

Finally, BNSF cites a reference in the Guidelines calling for potential modifications to the Guidelines to make the Guidelines "fully workable." Id. at 525. However, it was clear in Nevada Power II – and has been clear ever since – that presuming a SARR to be a competitor of the incumbent, and setting SARR divisions at the incumbent's variable costs, would make the Guidelines fully unworkable.

The Board has urged parties to SAC cases not to reargue settled issues unless they can present new evidence or arguments:

the parties to SAC cases are cautioned not to attempt to relitigate issues that have been resolved in prior cases. Unless new evidence or different arguments are presented, we will adhere to precedent established in prior cases.^[120]

and specifically, rejected use of this approach in McCarty Farms. Id. at 471-72.

¹¹⁹ See BNSF Reply Narr. at III.A-47.

¹²⁰ See General Procedures at 6.

BNSF presents no new arguments or evidence here – it simply repeats arguments that the ICC and the STB have consistently rejected in Nevada Power and other cases.

(c) “Modified” MSP

BNSF asks the Board to consider a second method to set cross-over divisions if the Board rejects its avoidable cost divisions proposal. BNSF calls its second proposal a “modified” MSP approach.¹²¹ Under the “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).¹²²

BNSF developed its mileage block adjustments by purportedly calculating the “system-average” origination and termination URCS variable costs for BNSF traffic in 2002. BNSF’s calculations produce a system-average cost per car of { }. Next, BNSF purports to calculate the corresponding origination and destination costs for { } car unit trains of shipper supplied and carrier supplied cars. BNSF calculates these costs at { } per railroad owned car and { } per shipper-owned car. BNSF then determines, using those figures, that unit train shipment origination/destination costs constitute { } of BNSF’s system-average origination costs in shipper cars { } and { } of BNSF’s system-average origination costs in railroad cars

¹²¹ See BNSF Reply Narr. at III.A-51.

¹²² Id.

{ }. BNSF proceeds to reduce the MSP 100 mile origin and destination mileage blocks to 25 miles (for shipper car movements) and 57 miles (for car movements).¹²³ BNSF's "modified MSP" approach, like its avoidable cost approach must be rejected.

First, as discussed above, the ICC and the Board have consistently rejected SARR divisions methodologies that set SARR divisions at levels equal to or near the incumbent's variable costs for providing service over the SARR. As the ICC stated in Nevada Power II, cross-over divisions set at or near the incumbent's variable cost levels "would allow for only a minimal contribution to the [SARR's] joint and common costs."¹²⁴ The ICC rejected this result as fundamentally inconsistent with governing SAC principles because it "reduces revenue before the entrant has the chance to recover its costs."¹²⁵

Similarly, the Board observed in Duke/NS I that setting cross-over divisions "down close to variable cost levels" would require that non-cross-over traffic "bear[] most of the fixed cost of the [SARR]" and "[t]he end result would deprive each

¹²³ See BNSF Reply electronic workpaper "BNSF URCS 2004.zip." BNSF goes on to claim that the results of its URCS analysis are supported by its calculations of variable costs for the LRS movement and by WFA/Basin's calculation of stand-alone costs for the LRR. See BNSF Reply Narr. at III.A-54.

¹²⁴ Id., 10 I.C.C.2d at 266.

¹²⁵ Id.

complainant shipper of the benefit of grouping traffic (i.e. realizing the economies of scale, scope and density) held out to them in Guidelines.” Id. at 18-19.

BNSF’s own evidence shows that its modified MSP approach produces results that the ICC and the Board have consistently rejected – i.e., divisions at or near the incumbent’s variable service costs. For example, BNSF calculates the aggregate URCS variable costs for the LRR cross-over traffic at { } million in 2005.¹²⁶ Using its modified MSP approach, BNSF calculates aggregate cross-over traffic LRR divisions in 2005 at { } million in 2005. The resulting R/VC ratio approximates { } ($\{ \}$ million $\div$ $\{ \}$ million). BNSF’s modified MSP calculations must be rejected for the very same reasons the Board has rejected other case proposals to set SARR divisions at the incumbent’s variable costs – they produce ridiculously low results.

Second, BNSF mistakenly assumes that the MSP 100-mile origin and destination blocks are a cost-based “system-average” block of costs akin to an URCS system-average cost.¹²⁷ BNSF’s 25/57 mileage block adjustments use URCS procedures to make a unit train-based downward adjustment to the asserted costs.

In fact, the 100-mile origin/destination blocks are not intended to – and do not – measure costs. Instead, the 100-mile blocks are intended to capture market-based revenues that apply regardless of the type of traffic involved. Thus, BNSF’s study is

¹²⁶ See WFA/Basin Rebuttal electronic workpaper “BNSF 2005 Variable Cost.xls.”

¹²⁷ See BNSF Reply Narr. at III.A-52.

predicated on a false starting premise – the 100-mile block is a pool of system-average costs – which leads BNSF to reach an invalid answer – the block should be reduced to reflect unit train efficiencies.

MSP is a “smoothed out” version of the MMP methodology.¹²⁸ The Board uses MMP to calculate actual, market-based divisions on traffic contained in its waybill sample. The Board’s waybill sample contains statistical data collected from terminating waybill carriers.¹²⁹ The data includes the line-haul revenues. For movements involving two or more carriers, the line-haul revenue shown on the waybill data is typically aggregated. For example, in a two carrier line-haul move, the waybill data will show the total line-haul charge invoiced to the shipper. The waybill data does not show the division earned by each carrier.

The Board uses the waybill data for various carrier-specific analyses. As part of these analyses, the Board must determine what each carrier charges on its portion of a joint haul. Since this division data is not captured in the waybill, the Board uses the MMP method to estimate each carrier’s actual revenue divisions. Under MMP “each carrier is assigned one ‘block’ for every 100 miles or part thereof that it carries the traffic, plus an additional block for originating or terminating the traffic; the total revenues are then allocated based on each carrier’s share of the total number of

¹²⁸ See Duke/NS I at 24.

¹²⁹ See 49 C.F.R. § 1244.

blocks.”¹³⁰ The purpose of MMP is to obtain an accurate estimate of the actual market divisions earned by the waybill sample carriers.

BNSF argues that the 100-mile origin and destination blocks are intended to measure origin and destination service costs. In support of this position, BNSF cites the Association of American Railroads (“AAR”) Waybill Sample User’s Guide. This User’s Guide describes the 100-mile origin block as “allow[ing] for pick-up and switching expenses” and describes the 100-mile destination block as “allow[ing] for delivery expenses.”¹³¹ While the 100-mile origin and destination blocks “allow” for origin and destination handling costs, the blocks are not intended to directly measure these costs. Instead, the sole purpose of the Board’s MMP methodology (including the 100-mile origin/destination blocks) is to measure market-based revenue divisions.

The Board uses MMP-derived divisions to construct carrier specific revenues. The Board’s costed waybill procedure utilizes these revenues, and railroad costs determined using URCS procedures, to develop R/VC ratios. Significantly, the Board does not use MMP to calculate costs because it would be inappropriate to do so. Instead, it uses MMP to calculate revenues.

The STB also utilizes the 100-mile origin and destination blocks to measure revenue divisions on all traffic captured by the waybill sample – including single car,

¹³⁰ See Duke/NS I at 17.

¹³¹ See AAR User Guide for the 1996 Surface Transportation Board Waybill Sample at 8-33 (July 30, 1997).

multiple car and unit train traffic. The STB, and the ICC before it, never saw any need to modify the origin blocks to account for allegedly different cost structures for the involved traffic. The Board, and the ICC, have for over 25 years considered the MMP origin/destination blocks to be part of a revenue allocation procedure designed and intended to produce accurate estimates of revenue divisions on all types of traffic.

Similarly, the ICC and the STB have consistently relied upon the MMP and MSP methods to provide an accurate estimation of market-based divisions in SAC cases.¹³² The evidence WFA/Basin present in this case demonstrates that MMP, and MSP, do in fact produce reliable estimates of actual market divisions the LRR would expect to negotiate with the residual BNSF.¹³³ This evidence stands un rebutted.

BNSF's cost study procedure is totally flawed – and its study result meaningless – because BNSF mistakenly confuses costs with revenues, and mistakenly applies a cost-based adjustment procedure to arbitrarily calculate reduced new divisions for the LRR.

Third, the Board opined in Duke/NS I that it might consider setting divisions using procedures other than MSP based upon an analysis of “the defendant carrier’s relative cost of providing service” over the SARR and non-SARR segment of the

¹³² See e.g., WPL I at 24; FMC at 27 n.62; TMPA I at 31.

¹³³ See WFA/Basin Op. Exhibits III-A-3 and III-A-4.

involved haul.¹³⁴ The Board further opined that to determine the “relative costs” a party would have to calculate variable costs over each segment and fairly allocate fixed costs:

There may be merit to allocating revenues based on the relative variable cost and average fixed cost to haul traffic over each segment of the move, if those costs can be fairly approximated.

Duke/NS I at 22.

While any “relative cost” test that ignores market conditions is wrong,¹³⁵ the Board need not address this issue since BNSF’s cost studies do not address, much less provide, a procedure that “allocat[es] revenues based on the relative variable and average fixed cost[s]” to haul the cross-over traffic.

BNSF’s cost studies focus solely on BNSF’s asserted costs to load and unload unit coal trains. BNSF’s studies do not calculate BNSF’s overall variable costs for transporting traffic on the SARR route segments, do not calculate BNSF’s variable costs for transportation over the SARR route segments, and do not calculate or allocate fixed costs. Also, any useable “relative cost” study would have to factor in the fact that the LRR is a “short haul” carrier that must allocate its variable and fixed costs over

¹³⁴ Id. at 20.

¹³⁵ See p. III-A-48 to 67 below.

substantially fewer miles than the residual BNSF since the average LRR cross-over movement is 71.1 miles and average residual BNSF movement is 938.9 miles.¹³⁶

BNSF's evidence falls far short of the "relative cost" study the Board called for in Duke/NS I. The Board should continue to rely on the MSP divisions methodology in this case.

(d) Market Realities

BNSF's avoidable cost and modified MSP approaches produce absurd results when given a real-world reality check. As the Board has observed, the "SAC constraint is meant to serve as a practical tool, not a mere exercise in contestable market theory divorced from its purpose of judging the reasonableness of the defendant carrier's pricing."¹³⁷ Similarly, the Board has observed that all SAC assumptions "must be ... consistent with the underling realities of real-world railroading."¹³⁸

BNSF's position, stripped to its core, is that BNSF is barely breaking even on originating PRB coal traffic. Under BNSF's avoidable cost approach, BNSF assumes its PRB revenue equals its variable costs. Under BNSF's modified MSP approach, BNSF assumes its PRB revenues are less than its variable service costs. These conclusions find no support in the reality of real-world railroading.

¹³⁶ See, e.g., FMC at 30 (reciting the fundamental rule of railroad economics "that short originating and terminating movements have higher relative costs").

¹³⁷ See AEPCO (STB served Aug. 19, 2002) at 6-7.

¹³⁸ See Xcel II at 12.

The PRB is the densest traffic segment on BNSF.¹³⁹ The most highly efficient trains in the BNSF system – unit coal trains – traverse the PRB track. The PRB market also is highly lucrative – as is most recently confirmed in a comprehensive study performed by an independent third party.¹⁴⁰ Indeed, the market is so lucrative that a third carrier – the DM&E – has sought, and obtained preliminary STB approval to enter it.¹⁴¹ Yet, under BNSF’s divisions analysis, its PRB traffic barely breaks even and, over time, the PRB coal origination market is not sustainable, because it is not paying anything towards BNSF’s fixed system costs. That simply is not right.¹⁴²

If the Board finds that SAC revenues do not substantially exceed SAC cost on the densest portion of the BNSF network, the SAC test will cease to be of use to shippers in any complaint case – which is clearly BNSF’s objective.¹⁴³ SAC will become a regulatory standard so far removed from the reality of real-world railroading that it will

¹³⁹ American Association of State Highway and Transportation Officials, Transportation – Invest in America, Freight – Rail Bottom Line Report (July 2003) at 117 (“AASHTO Study”). See WFA/Basin Reply electronic workpaper “Freight Rail Report.pdf.”

¹⁴⁰ Id.

¹⁴¹ See Dakota, Minnesota & Eastern R.R. Construction into the Powder River Basin, STB Finance Docket No. 33407 (STB served Jan. 30, 2002).

¹⁴² For example, WRPI – a real world PRB origin carrier – obtained divisions producing average R/VC ratios in the 200% range. See WFA/Basin Rebuttal Workpapers pp. 171-192.

¹⁴³ The Board counsel made this very point in PSCo. See Board’s Xcel Brief at 36 (observing that BNSF objects to “any application of the SAC test that results in relief to captive shippers”).

become a meaningless exercise – and one that will leave captive shippers with no meaningful recourse against monopoly carrier pricing.

(e) Market Divisions

In their opening evidence, WFA/Basin presented substantial evidence demonstrating that WFA/Basin's reliance on MSP produced conservative results when compared to the actual market divisions that LRR would negotiate with the residual BNSF in the marketplace.¹⁴⁴ On Reply, BNSF either ignores this evidence, or presents make-weight criticisms of it. BNSF presents no evidence of its own concerning the level of market-based divisions the LRR would expect to negotiate with the residual BNSF. LRR's Opening market evidence can be summarized under the headings: WRPI divisions; BNSF divisions; and industry practice.

- WRPI Divisions. The LRR is the mirror-image of WRPI. WRPI entered the PRB market in the mid-1980's and negotiated a divisions agreement with its connecting carrier – the UP.¹⁴⁵ WRPI's market-based divisions exceeded those that WRPI would have obtained under MSP.¹⁴⁶ WRPI was able to negotiate favorable market divisions because it – unlike the UP – had direct access to a highly valuable origin

¹⁴⁴ See WFA/Basin Op. Exhibit III-A-3.

¹⁴⁵ Id. at pp. 3-5.

¹⁴⁶ Id.

franchise – the PRB.¹⁴⁷ The LRR, as a replacement carrier to BNSF for utility coal traffic, possesses the same market power as WRPI, – i.e. it – not the residual BNSF – has direct access to the PRB mines to originate its PRB utility coal traffic.

David Weishaar, WRPI's principal coal marketing officer, has direct personal knowledge of the WRPI/UP divisions agreement and is also familiar with the proposed LRR/residual BNSF traffic arrangements. On Opening, Mr. Weishaar confirmed that from a practical market perspective, the LRR would be able to negotiate divisions at least equal to (if not greater than) MSP divisions.¹⁴⁸

On Reply, BNSF claims that WFA/Basin “have no supporting data” for the WRPI divisions calculation.¹⁴⁹ That is not correct. WFA/Basin's WRPI evidence is sponsored by Mr. Weishaar. Mr. Weishaar has stated, under oath, that WRPI's divisions exceeded MSP divisions.¹⁵⁰ Confidentiality restrictions precluded Mr. Weishaar from submitting WRPI/UP's actual movement-specific divisions arrangements.¹⁵¹ However, BNSF does not dispute that Mr. Weishaar was intimately familiar with the WRPI/UP arrangements, nor does BNSF challenge Mr. Weishaar's credibility.

¹⁴⁷ Id.

¹⁴⁸ Id.

¹⁴⁹ See BNSF Reply Narr. at I-12 n.9.

¹⁵⁰ See WFA/Basin Op. Exhibit III-A-3, pp. 3-5.

¹⁵¹ Id.

WFA/Basin also introduced publicly available evidence – which BNSF ignores – showing that the WRPI divisions approximated 16.3 mills per ton mile on average hauls of 185 miles. Mr. Weishaar found that the LRR's average divisions, which approximate 20.7 mills per ton mile, are in line with WRPI's, after factoring in the fact that the LRR's average length of haul (71.1 miles) was less than half of WRPI's average length of haul (185 miles).

BNSF also argues that the WRPI/UP divisions are not significant because the WRPI/UP relationship was not "arms length."¹⁵² Mr. Weishaar has reviewed BNSF's assertion and informs the Board that it is wrong. At the time CNW, WRPI and UP entered into their divisions arrangements, CNW/WRPI and UP were separate carriers and engaged in "arms length" bargaining over the terms of the divisions.

WRPI and UP did align themselves closely for marketing purposes since WRPI was UP's only means of accessing the PRB in a manner that would permit UP to compete with BNSF. Mr. Weishaar observes that he would expect the LRR and BNSF also to closely align for marketing purposes because, as BNSF's replacement, the LRR provides BNSF with the only way of accessing the PRB in a manner that would permit BNSF to compete with UP for utility coal traffic movements.

- BNSF Divisions. BNSF produced actual divisions data in discovery. That data is analyzed in WFA/Basin Op. Exhibit III-A-4. That data shows that on

¹⁵² See BNSF Reply Narr. at I-12.

interline coal movements consisting of a short-haul segment and a long-haul segment, the short-haul carrier earned revenue shares that are comparable to, or higher than, the LRR earns under MSP. The results are summarized in Rebuttal Table III-A-2 below:

Rebuttal Table III-A-2 Comparison of MSP Divisions to Actual Divisions			
Movement Length (Short-Haul Carrier) (1)	Short-Haul Carrier MSP Division \$ (2)	Short-Haul Carrier Actual Division (3)	Difference Col. 3 - Col. 2 (4)
1. { }	{ }	{ }	{ }
2. { }	{ }	{ }	{ }
3. { }	{ }	{ }	{ }
4. { }	{ }	{ }	{ }
5. { }	{ }	{ }	{ }
6. { }	{ }	{ }	{ }
7. { }	{ }	{ }	{ }
8. { }	{ }	{ }	{ }
9. { }	{ }	{ }	{ }
10. { }	{ }	{ }	{ }
11. { }	{ }	{ }	{ }
12. { }	{ }	{ }	{ }
13. { }	{ }	{ }	{ }
14. { }	{ }	{ }	{ }
15. { }	{ }	{ }	{ }
16. { }	{ }	{ }	{ }
17. { }	{ }	{ }	{ }
18. { }	{ }	{ }	{ }
19. { }	{ }	{ }	{ }
20. { }	{ }	{ }	{ }
21. { }	{ }	{ }	{ }

On Reply, BNSF presents no evidence to rebut this showing.

- Industry Practice. WFA/Basin also presented evidence on Opening showing that, as matter of industry market practice, short-haul originating or terminating carriers earn divisions that are equal to, or higher than, MSP divisions.¹⁵³ Again, BNSF presents no responsive evidence to this well-known industry practice.

(f) Relevance of Market Divisions

BNSF apparently chose to ignore WFA/Basin's market evidence based upon its reading of recent STB precedents – particularly Duke/NS.¹⁵⁴ WFA/Basin review the applicable precedents below and, in light of this review, request that the Board revisit its Duke/NS rulings concerning the relevance of market factors in determining SAC divisions.

In the ICC's seminal Nevada Power II decision, the ICC ruled that cross-over traffic divisions should be allocated on the basis of market principles. Id. at 268. This ruling was explained in detail in ICC Chairman McDonald's comment accompanying the decision:

A third generic issue settled by this decision is how to estimate the *revenue* that a SARR would earn on cross-over traffic. Because this traffic is not currently interlined, there are no actual revenue shares, or "divisions" data, available. We find that the

¹⁵³ See WFA/Basin Op. Exhibit III-A-3, pp. 5-6.

¹⁵⁴ See Duke/NS I at 20.

proper approach is to estimate what the *market-based* divisions would be, and this will be the standard for future cases.

We use here a mileage proration *method* for estimating market-based divisions. That is, the SARR's share of the total revenue is set equal to its share of the total mileage. However, I view our acceptance of that particular method to be a case-specific finding. Based on the specific evidence of record and our informed judgment about the workings of rail markets, we find that mileage-based revenue divisions offer a reasonable approximation in this case to the market-based divisions that would be available to the SARR.

Market-based divisions result from the interaction of supply considerations (the relative costs incurred by the carriers in providing the interline movement) and demand considerations (the relative bargaining power of the two carriers)...

Id. at 280.

The ICC and the STB adhered to this Nevada Power market-based divisions rule in all subsequent SAC decisions until Duke/NS. See, e.g., FMC at 31; TMPA at 31. The rule was also universally supported by both carriers and shippers alike as the proper standard for the Board to apply in SAC cases. For example, in FMC, UP's principal revenue witness testified that "[i]n the 'contestable' world, what should determine divisions is relative costs and general market place tendencies."¹⁵⁵

¹⁵⁵ See FMC Corp. v. Union Pacific R.R., UP Reply Evidence, Verified Statement of Richard B. Peterson (filed March 31, 1999) at 19, WFA/Basin Op. electronic workpaper "III-A-Peterson wp."

The Board abruptly reversed course in Duke/NS. In that case, Duke's proposed SARR provided origin service for many eastern coal origins NS served.¹⁵⁶ NS argued that on many of the movements NS was the sole destination carrier; that it exerted bottleneck pricing power over these shipments (because the destination shippers could source their coal from origin mines served by NS or other carriers); and that, as a result, NS would use its bottleneck market power to negotiate SARR's divisions on cross-over traffic "down close to variable cost levels." Id. at 18.

In its Duke/NS I decision, the Board presented a hypothetical where the residual incumbent exerts bottleneck pricing power over a SARR cross-over traffic movement. The Board appeared to agree with NS's divisions analysis – i.e., that NS could drive down the SARR's divisions on the cross-over traffic to levels close to variable costs. The result, the Board postulated, would require the complainant shipper to "bear most of the fixed costs" of the SARR facilities, thus "depriv[ing] [the complainant] shipper of the benefit of grouping traffic (i.e., realizing the economics of scale, scope and density)." Id. at 19. The Board went on to hold that, as a result, marketplace divisions have "no place in a SAC analysis:"

Thus, a debate over how much of the revenues from cross-over traffic the hypothetical carrier could negotiate with the residual defendant has no place in a SAC analysis. (Indeed, the defendant carrier does not

¹⁵⁶ See Duke/NS I at 42-43.

negotiate with itself as to whether one segment of its line should be allocated a larger share of the revenues from a movement than another segment of its own line.) Rather, the revenue allocation issue should reflect, to the extent practicable, the defendant carrier's relative costs of providing service over the two segments.

Id. at 19-20 (footnote omitted).

The Board also observed that NS refused to provide actual divisions data, but concluded such production would not be particularly instructive:

Nor would information about NS's actual divisions with other carriers (which Duke requested in discovery but did not receive) be particularly instructive, as those divisions presumably reflect a wide range of commercial considerations across a broad spectrum of traffic and gateways.

Id. at 20 n.29. WFA/Basin respectfully submit that the Board's Duke/NS decision to eliminate consideration of marketplace decisions was wrong for a number of interrelated reasons:

First, the Board in Duke/NS did not address – much less attempt to distinguish – the long line of ICC and STB cases holding that cross-over traffic divisions should be set using “market-based” divisions. The Board's failure to acknowledge these

longstanding precedents, and to explain why the rulings set forth therein were incorrect, violates basic principles of administrative adjudication.¹⁵⁷

Second, the Board's decision ignored the fact that the SARR is a replacement for the incumbent. As a replacement carrier, the SARR would necessarily negotiate divisions with the residual incumbent. As the ICC has observed, "[d]ivisions agreements are arrangements between connecting railroad companies determining how the carriers will divide the revenues received from multiple-carrier ... movements."¹⁵⁸

Third, the Board's ruling in Duke/NS I established an impermissible barrier to entry. The SAC test is predicated upon the modeling of a SARR that faces no barriers to entry. For SAC purposes a barrier to entry consists of "any type of cost that a new entrant would have to incur that was not actually incurred by the defendant carrier."

TMPA II at 23. "Entry barriers can take the form of any friction that would slow entry into the industry and uncommitantly increase the cost of entry." WTU 1 S.T.B. at 657 n.37.

¹⁵⁷ See Burlington N. & Santa Fe Ry. Co. v. STB, 403 F.3d 771, 778 (D.C. Cir. 2005) (remanding a decision to the STB because the agency "overlooked binding precedent"); New York Cross Harbor R.R. v. STB, 374 F.3d 1177, 1188 (D.C. Cir. 2004) (finding that the Board acted arbitrarily and capriciously when it failed to distinguish contrary precedent); Borough of Columbia v. STB, 342 F.3d 222, 229 (3rd Cir. 2003) (stating that if an agency departs from precedent without a "reasoned explanation" the court may find that the agency acted arbitrarily and capriciously).

¹⁵⁸ See Official – Southwest Divisions via Southern Freight Territory, ICC Docket No. 25390 (ICC decided July 6, 1990) at 1990 WL 288358*1.

In a SAC case, the SARR must evaluate whether to enter a particular market. When a SARR will carry cross-over traffic, the SARR must evaluate what its revenue division will be with the residual incumbent. The evaluation will necessarily focus on both market and cost factors. A SARR cannot – and will not – enter a market where it cannot recover its costs. And, in order to determine whether it can recover its costs, a SARR must evaluate its ability to negotiate a division with the residual incumbent that allows it to recover its costs. This is a market-driven analysis.

Similarly, when BNSF (or any other carrier) evaluates its decision to enter into a new market, it must look at its anticipated costs and anticipated revenues. When the new market involves joint line transportation, the carrier must evaluate its ability to negotiate necessary divisions. This, of course, is also a market-driven exercise.

Setting a SARR's divisions on cross-over traffic using a formula based on the residual carrier's costs can – and does – impose entry constraints that the residual carrier did not incur. For example, when BNSF was making decisions to enter into the PRB market, or to expand its PRB market capabilities, it was not required (and certainly did not) project revenue divisions based upon the cost structure of its connecting carriers. Instead, it evaluated its market position, and leverage, vis-a-vis its connections.

Fourth, the Board's decision violated the basic SAC rule that a new entrant must be able to utilize the "same productive techniques" as the incumbent. See Nevada Power I, 6 I.C.C.2d at 45. BNSF – and all other real world carriers – negotiate divisions

using market leverage as a "productive technique." The Board's cost-based divisions measures strip the LRR of the market-based divisions techniques utilized every day by BNSF and other rail carriers.

The Board's SAC rules are grounded in the first principles of contestability theory. As stated in Contestable Markets:

Entrants are expected to calculate the profits that entry can bring them.... In all of these [contestability] models, entry is assumed to be free in the sense that the act exerts no explicit costs and that entrants suffer no disadvantages in the techniques available to them.

Id. at 4. A SARR looking to enter a market is perfectly free under contestability standards to serve whatever market it so chooses and to use the productive techniques available to the incumbent. Here, the LRR has chosen to enter into a market (the PRB-to-LRS market) and can use the same productive techniques used by the incumbent – i.e., interline traffic and negotiate market-based divisions.

Fifth, the Board's analysis in Duke/NS I was predicated upon a circular, outcome-determinative analysis. In Duke/NS I, the Board assumed that all SAC cases involve bottleneck transportation and that, in the real world, bottleneck carriers always negotiate very favorable (for them) divisions. As WFA/Basin demonstrated in their opening evidence, this fact pattern has no application in the present case because the LRR

cross-over traffic movements involve a multitude of different traffic patterns.¹⁵⁹

WFA/Basin also demonstrated in their opening evidence that the LRR would have substantial market leverage in negotiating divisions with the residual BNSF – a fact that BNSF does not dispute in its reply filing.

Sixth, the Duke/NS I determination produces theoretical inconsistencies in the Board's SAC analysis. In prior SAC cases, the ICC and the STB have always relied on market-based SARR rates. For example, if a SARR replaces the incumbent's service for origin-to-destination traffic, the Board assumes SARR rates equal the incumbent's rates – rates that are typically set by market forces on competitive traffic.¹⁶⁰ Similarly, if a SARR replaces the incumbent's service from origin-to-interchange with a third carrier, the Board assumes the SARR division equals the incumbent carrier's actual division – again a division typically set by market forces.¹⁶¹

It produces fundamentally inconsistent results to set SARR revenues on through moves, and on most interchange moves, using market-based rates, and then turn-around and ignore market forces in setting divisions on cross-over traffic. This inconsistency is highlighted by BNSF's evidence in this case. In its SAC analysis, BNSF assumes the LRR earns a market rate on the single line LRS movements. BNSF

¹⁵⁹ See WFA/Basin Op. Exhibit III-A-3, pp. 8-9.

¹⁶⁰ See, e.g., CPL at 19; Duke/NS I at 64; TMPA I at 27; WPL I at 24.

¹⁶¹ See Nevada Power II at 268.

calculates that rate in 2005 as averaging { } per ton (exclusive of the fuel surcharge).¹⁶² If, however, the single line rate was a cross-over movement, BNSF would calculate the avoidable cost division at { } per ton¹⁶³ – a result that has no correlation whatsoever to the market.

Seventh, BNSF itself concedes that contestability theory calls for the establishment of SARR divisions using market principles. BNSF posits a situation where the SARR and incumbent compete for the SARR business, with the resulting division set based upon the assumed results of the market competition.¹⁶⁴

BNSF's assumption that a SARR and the incumbent engage in pre-entry price competition is wrong for the reasons set forth above. A SARR is properly seen as a replacement for the incumbent. However, as a replacement carrier, the SARR would need to negotiate divisions with the residual incumbent – and those negotiations would necessarily reflect the market positions of both the SARR and the incumbent.

Eighth, the Board postulated in Duke/NS I that actual divisions data would not “be particularly instructive, as those divisions presumably reflect a wide range of commercial considerations across a broad spectrum of traffic and gateways.”¹⁶⁵ This

¹⁶² See BNSF Reply Errata electronic workpaper “LRR Traffic and Revenue _ WFA/Basin Opening _ BNSF Revised.xls.”

¹⁶³ See WFA/Basin Rebuttal electronic workpaper “BNSF 2005 Variable Cost.xls.”

¹⁶⁴ See BNSF Reply Narr. at III.A-36.

¹⁶⁵ Duke/NS II at 20 n.29.

statement is true if the referenced actual divisions data refers to the totality of railroads' system-wide divisions. However, the system divisions data can be broken down to find comparable market division data. That is exactly what WFA/Basin have done in this case.¹⁶⁶

Ninth, WFA/Basin's approach is also consistent with regulatory practice. The STB has statutory authority to set divisions on joint rates in cases where the parties cannot agree.¹⁶⁷ The ICC, the STB's predecessor, had the same authority and exercised it frequently over the years. In exercising its authority, the ICC routinely would consider evidence of divisions set under comparable market circumstances.¹⁶⁸ As observed by one court:

A validly established and currently applied basis of divisions of revenue derived from similar traffic moving in the same or adjacent territory under similar circumstances may properly be considered [in prescribing divisions]^[169]

Conversely, the ICC did not prescribe divisions based solely on the "relative costs" of the involved carriers. As observed by the Supreme Court: "[r]elative cost of

¹⁶⁶ See WFA/Basin Op. Narr. at III-A-17 n.28.

¹⁶⁷ See 49 U.S.C. § 10705.

¹⁶⁸ See Rates on Lumber and other Forest Products from Points in Arkansas, 31 I.C.C. 673, 676 (1914).

¹⁶⁹ Boston and Maine R.R. v. United States, 208 F.Supp. 661, 677 (D.Mass 1962).

service is not the only factor to be considered in determining just divisions.”¹⁷⁰ As summarized by the ICC:

There is no single yardstick or criterion which can be employed in determining fair divisions. *Baltimore & O.R. Co. v. United States*, 298 U.S. 349, 359. The question of what constitutes just and reasonable divisions involves the making of practical judgments and cannot be solved as though it were a mathematical problem. *Boston & Maine R.R. v. United States*, 208 F. Supp. 661, 675.^[171]

Last, the Board’s ruling arbitrarily departs from the Board’s waybill sample procedures. These procedures, as described above, are intended to produce accurate forecasts of market divisions.

In Duke/NS I, the Board takes a method it utilizes to determine market-based divisions (MMP) and attempts to convert it into a method for determining “fair[]” cost-based divisions. However, MMP is not – and never was – intended to determine “fair” divisions between carriers based on relative service costs. Instead, it is a Board-approved method for determining actual market-based divisions. There is no principled way to turn a market-based division estimate method into a cost based division method.

* * *

¹⁷⁰ United States v. Abilene & S. Ry., 265 U.S. 274, 284 (1924).

¹⁷¹ Akron, Canton & Youngstown R.R. v. Atchison, Topeka & Santa Fe Ry., 322 I.C.C. 491, 499 (1963).

For these reasons, WFA/Basin respectfully request the Board to reconsider its ruling in Duke/NS I and to return to the Nevada Power rulings made by the ICC and the Board prior to Duke/NS I – i.e., SARR divisions should be set using market principles.

(d) Other

i. Cross-Subsidy

BNSF throws in a bogus cross-subsidy claim at the tail end of its excessively long discussion of SAC traffic group issues.¹⁷² BNSF devotes little discussion to its cross-subsidy claim – and with good reason. The LRR contains no cross-subsidies.

BNSF's cross-subsidy contentions focus on LRR traffic movements that originate from northern PRB mines and interchange with the residual BNSF at Donkey Creek and Campbell. BNSF claims that the LRR revenues for this traffic (using WFA/Basin's revenue projections) exceed the SAC costs for this segment of the LRR. This overage, BNSF opines, "makes it virtually certain that these revenues are being used to subsidize the LRR facilities south of Donkey Creek."¹⁷³ BNSF goes on to propose a

¹⁷² See BNSF Reply Narr. at III.A-63 to 66.

¹⁷³ Id. at III.A-64.

complex methodology to eliminate the cross-subsidy – a methodology that substantially reduces the LRR's revenues.¹⁷⁴

BNSF's analysis assumes that a "cross subsidy" occurs when SARR revenues for a SARR segment exceed the SARR costs. BNSF made exactly the same argument in PPL, and the Board properly rejected it:

In examining whether the hypothesized [PPL SARR] incorporates a proscribed cross-subsidy, the appropriate inquiry is not, as BNSF suggests, whether a particular subset of traffic is generating revenues in excess of the SAC associated with serving that subset of traffic, but whether there is a readily identifiable subset of traffic that would not cover the collective attributable costs associated with serving the traffic.

PPL at 9-10 (footnote omitted).

The Board further observed that if BNSF's proposed cross-subsidy test was accepted, SAC would not work:

BNSF's proposed standard for limiting the revenue contribution from cross-over traffic in excess of SAC would make it unlikely that a shipper could prevail on a complaint in which the SAC analysis relied extensively on cross-over traffic. Under BNSF's approach, revenues from cross-over traffic could never exceed SAC but, in order to show that a rate is unreasonable, a shipper must demonstrate that revenues from all movements in its traffic group in fact exceed

¹⁷⁴ Id. at III.A-64 to 66.

Exhibit III-A-1

Redacted

EXHIBIT 3A

WFA/BASIN'S OPENING EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

INDEXING OF SARR OPERATING EXPENSES

relied on this index mix in past cases to inflate non-land road property accounts.⁶

c. Revenues

WFA/Basin discuss the procedures for forecasting SAC revenues in Part III-A-3. Where WFA/Basin revenue procedures call for forecasting changes in the Board's Rail Cost Adjustment Factor ("RCAF") indices, WFA/Basin utilize Global Insight's most recent RCAF forecasts.⁷ Where WFA/Basin's revenue procedure calls for forecasting EIA Retail On-Highway Diesel Prices, WFA/Basin utilize EIA's most recent forecast of these prices.⁸ Finally, where WFA/Basin's revenue procedure calls for forecasting changes in the GPD/IPD index, WFA/Basin utilize EIA's most recent GPD/IPD forecast.⁹ Similar procedures and forecasts have been relied upon by the STB in prior cases.¹⁰

d. Operating Expenses

The STB has recognized in all of its recent SAC decisions that SARR operations will experience productivity improvements over time. See WPL I at 106 (a SARR "built today would realize future productivity gains"); CPL at 27 (a SARR should

⁶ See, e.g., Xcel I at 34 (approving use of Global Insight for capital asset forecasts); CPL at 28.

⁷ See Xcel I at 34 (approving use of Global Insight RCAF forecasts). Global Insight's most recent RCAF forecast is included in electronic workpaper file "Global Insight RCAF Forecast_DEC04.pdf."

⁸ EIA's most recent forecast of Retail On-Highway Diesel Prices is included in electronic workpaper file "ref aeotab_12 05.xls."

⁹ EIA's most recent GDP/IPD forecast is included in electronic workpaper file "ref aeotab_19 05.xls."

¹⁰ See, e.g., Xcel I at 34 ("Board prefers impartial forecasts of future inflation").

“realize productivity gains over the course of the SAC analysis period”); Duke/ CSX at 30 (same); Xcel I at 33 (same).

i. WRPI Experience

The Board's conclusions concerning SARR productivity gains are supported in this case by the real-world WRPI experience. As described in detail in Exhibit III-A-3, WRPI entered the PRB transportation market in the mid-1980's. At the time it did so, WRPI, like the LRR, was a modern state-of-the art rail carrier. However, being state-of-the art when it entered the market did not prevent WRPI from becoming substantially more productive over time.

Richard McDonald was WRPI's chief operating officer, and David Weishaar was WRPI's chief coal marketing officer. They observe that, on the operating side, WRPI initiated operations in 1984 using 3,000 horsepower SD40-2 locomotives, 4 head-end locomotives per train, 100-ton cars, 110-car trains and 4 crew members per train. (WRPI also started operations using cabooses, although these were replaced by EOTDs within two years and WRPI's crew size was also reduced from 4 to 3 during the same general time frame.) By WRPI's last year of independent operation (1994), Messrs. McDonald and Weishaar report that WRPI had converted its locomotive fleet to more efficient 4,000 horsepower GE C-40-8 locomotives and had also started to acquire 4,400 AC-traction locomotives from GE; had reduced all locomotive consists to 3 locomotives; had started using a distributed power (“DP”) locomotive configurations on some trains; was using larger capacity (106 to 120 ton) cars; and had increased train sizes to 115-120 cars.

Messrs. McDonald and Weishaar emphasize that all of these operational changes increased WRPI's efficiency and decreased WRPI's service unit costs. They also report that since 1995 (when UP acquired WRPI), UP's PRB coal operations have continued to become more efficient with the use of all-AC locomotives (4400 horsepower C44-9Ws and 4,000 horsepower SD70MAC's), use of fewer locomotives per train (normally a maximum of 3 in a DP configuration), increased use of 120-ton cars and increased use of long trains (e.g., 135-car trains).

The operating changes Messrs. McDonald and Weishaar discuss are summarized in Table III-G-2 below :

Table III-G-2 Changes in Productivity For WRPI/UP Powder River Basin Coal Trains			
<u>Item</u>	<u>1984</u>	<u>1995</u>	<u>2004</u>
Locomotive Type	SD40	C-40-8, some C4400/C44-9W	C44-9W, SD70MAC
Locomotive Horsepower	3000	3800-4400	4000-4400
Locomotives Per Train	4	3	3
Distributed Power	No	Some	All
Normal Train length (cars)	110	115-120	135
Normal Tons Per Car	100	106-120	120
Normal Tons Per Train	11,000	12,000- 14,000	15,000- 16,000
Normal Train Crew Members	4	2	2

Messrs. McDonald and Weishaar also report that WRPI enjoyed many other forms of productivity gains brought on by traffic growth, better deployment of assets,

technological changes and other factors.

ii. Sources of LRR Productivity Gains

The LRR, like WRPI, begins service as an efficient unit train coal railroad. However, just like WRPI, the LRR will achieve substantial productivity gains. Among the potential areas for productivity gains are the following:

- More Efficient Locomotives. The LRR locomotive fleet is comprised of 4,000 horsepower SD 70-MAC's. This is currently the top-of-the-line BNSF coal locomotive. However, history shows what is the top-of-the-line today will not be the top-of-the-line a few years from now. Currently, the railroad-industry is designing the next generation state-of-the-art unit train locomotives. The locomotives will be higher horsepower, more fuel efficient, less costly to maintain, and will include a variety of new technologies designed to reduce railroad operating costs.¹¹ Press reports detail these on-going locomotive research, study and testing efforts:

- 6,000 horsepower locomotives are now being built and tested.¹²
- New technologies are being studied to equip locomotives with advanced microprocessors and other information technology features that will allow for dynamic monitoring of locomotive

¹¹ See William C. Vantuono, "Cars and locomotives: Building for bigger capacity," Railway Age (Sept. 1999) at 2-3 (web version), Workpapers Vol. 11, pp. 6097-6101; Don Geiger, "Innovations, Locomotive Technologies Save Fuel, Protect Environment," Railway Age (Nov./Dec. 2004) at 8, Workpapers Vol. 11, p. 6102; William C. Vantuono, "Tier 2 for the road," Railway Age (March 2005) at 23-28, Workpapers Vol. 11, pp. 6103-6108.

¹² See GE Annual Report 1996, at 1 (web version), Workpapers Vol. 11, pp. 6109-6110, Vantuono, Railway Age (Sept. 1999) supra, at 2, Workpapers Vol. 11, p. 6098.

functions leading to fuel efficiency gains.¹³

- On board locomotive management systems are being studied that will support multiple subsystems (e.g., self diagnostics, Positive Train Control, and wired or wireless ECP braking).¹⁴
- Cycle time for locomotive maintenance, reportedly now at 120 days for new locomotives, will likely be extended to 180 days, for the next generation locomotives.¹⁵

Introduction of the next generation locomotives should also reduce the number of locomotives the LRR will need to use. For example, use of new higher horsepower locomotives could be used in a "swing" position so that use of helper units is reduced over time, and eventually eliminated.¹⁶

More Efficient Railcars. Research and testing is underway for next generation coal cars that will be larger and more efficient. Press reports detail these ongoing research studies and testing:

- The rail industry is actively beginning to use 315,000 gross weight on rail coal cars.¹⁷

¹³ See William C. Vantuono, "Failure is not an option," Railway Age (Sept. 2003) at 57-62, Workpapers Vol. 11, pp. 6111-6115.

¹⁴ Id.

¹⁵ See Vantuono, Railway Age (Sept. 1999), supra at 3, Workpapers Vol. 11, p. 6099.

¹⁶ Observation of WFA/Basin rail operations expert Paul Smith.

¹⁷ See Vantuono, Railway Age (Sept. 1999) supra, at 1, Workpapers Vol. 11, p. 6097; Tom Judge, "Shortlines struggle to meet HAL challenges," Railway Track and Structures (Nov. 1999) at 2-3 (web version), Workpapers Vol. 11, pp. 6116-6119; "Johnstown America Delivers Two-Phase 1,330-Unit Coal Car Order to Commonwealth Edison (ConEd)," Johnstown American Press Release (Oct. 1999) at 2 (web version), Workpapers Vol. 11, pp. 6120-6121.

- Research is on-going to design new coal cars that have lower tare weights than current state of the art lightweight aluminum cars.¹⁸
- Car wheels are being designed using new metal alloys, producing wheels that require less maintenance and result in increased wheel life.¹⁹
- Research is on-going to design new suspension trucks for bulk commodity cars in order to reduce wheel wear and decrease rail car maintenance costs.²⁰

More Efficient Train Sizes. The LRR trains are currently sized as BNSF-sizes them today. However, the history of unit train operations in the west is that, over time, unit train sizes increase. The WRPI experience, discussed above, illustrates this trend. Railroads are now actively studying and testing ways to increase coal train sizes to maximize productivity. For example, UP is now testing 200 to 250 car unit trains on its system.²¹ The CN has also publically announced plans to increase many of its train sizes to 150 cars.²² The LRR, as an efficient originator of PRB coals, will also increase its train

¹⁸ See Jim Watkins, "Forecasting Annual Energy Outlook Coal Transportation Rates," EIA/Issues on Midterm Analysis and Forecasting 1997 (1997) at 78, Workpapers Vol. 11, pp.6122-6129; Johnstown America Press Release (Oct. 1999), supra, at 1-2, Workpapers Vol. 11, pp. 6120-6121.

¹⁹ See Transportation Technology Center, Inc.'s ("TTCI") Annual Report 2002 at 17-18, Workpapers Vol. 11, pp 6130-6151; TTCI Annual Report 2003 at 21, Workpapers Vol. 11, pp. 6152-6179.

²⁰ See TTCI Annual Report 2002, supra, at 8, Workpapers Vol. 11, p. 6140.

²¹ Observation of WFA/Basin operations expert Paul Smith.

²² See Vantuono, Railway Age (Sept. 1999), supra, at 1, Workpapers Vol. 11, p. 6097.

sizes when it is economically and technically feasible to do so.

More Efficient Train Operating Systems. The rail industry is studying ways to improve operating procedures, including the following:

- Research and testing are now on-going on new management systems that will dynamically track locomotive performance and alert users to impending maintenance problems, leading to decrease in costly unplanned locomotive maintenance.²³
- New Positive Train Control systems are being tested that will increase train speeds and improve system usage by updating the locations faster than conventional signaling control systems.²⁴
- Research is on-going over use of GPS tracking systems that assist railroads in running more trains over particular routes, thus increasing system efficiency.²⁵

More Efficient Maintenance Procedures. Railroads are studying ways to make the maintenance programs more efficient. According to industry reports:

- The AAR is developing Rail Profile Maintenance Software that characterizes interaction between railcars and rail in a manner that allows the user to identify higher stress

²³ Id. at 3-5, Workpapers Vol. 11, pp. 6099-6101.

²⁴ See TTCI Annual Report 2002, supra, at 11, Workpapers Vol. 11, p. 6143; TTCI Annual Report 2003, supra, at 22, Workpapers Vol. 11, p. 6175; William C. Vantuono, "The Magnificent 7," Railway Age (Feb. 2004) at 31 Workpapers Vol. 11, pp. 6180-6187. FRA Five Year Strategic Plan for Railroad Research, Development, and Demonstrations (March 2002) ("FRA Five Year Strategic Plan") at ES-6 to ES-7, 2-2, Workpapers Vol. 11, pp. 6188-6200.

²⁵ See FRA Year Strategic Plan, supra, at 2-2, Workpapers Vol. 11, p. 6200.

areas for preventative maintenance,²⁶

- The AAR is developing performance-based track geometry inspection procedures that will lead to new real-time inspection methods and improved preventive maintenance activities.²⁷
- The AAR is developing new rail flaw and broken rail inspection systems that will streamline inspections and more quickly pinpoint defects.²⁸

Increased Labor Productivity. Real-world railroads are constantly instructing their employees to take actions that increase rail productivity. The LRR will be no different. LRR employees, like those of any successful railroad, will find ways to increase system productivity. For example, the LRR will have substantial over capacity – particularly in its early years of operation – because it is configured to handle its peak year (2024) traffic volume – volume that is 7.0% more than its 2005 traffic volume. The LRR's train cycle times are also modeled to meet peak year demands. Enterprising engineers, crews and dispatchers are likely to find many ways to increase system velocity (and reduce system unit costs) in the many years prior to the 2024 peak year.

Similarly, LRR employees – like the employees at any railroad – should find a myriad of other ways to run their railroad more efficiently. By its nature, this type

²⁶ See TTCI Annual Report 2002, supra, at p. 5, Workpapers Vol. 11, p. 6137.

²⁷ See id.

²⁸ See TTCI Annual Report 2002, supra, at 6-8, Workpapers Vol. 11 pp. 6138-6140.

of productivity is largely a trial-and-error and learn-by-doing process.²⁹ Also, the number of employees that the LRR may need over time is likely to decrease as technology advances. For example, the industry is actively studying engineer-only operations.³⁰ The industry is also looking at a remote control trains.³¹ The LRR is an ideal candidate for both options since it is located in a rural area and operates only unit trains.

Traffic-Based Efficiencies. In Xcel I, the Board observed that its DCF model “would reflect some modest productivity improvements (lower costs per ton) over time because it holds constant several cost components ... even as tonnages increase.” Id. at 34. However, the Board’s DCF model does not hold constant most consequential operating costs (e.g., train operating personnel costs, and locomotive-related costs). Instead, these costs move-up in lock-step with SARR tonnage increases.

Railroads experience productivity growth when changes in outputs (e.g., ton-miles) increase faster than changes in inputs (e.g., labor or equipment). The LRR should experience similar traffic-based productivity improvements.

Information Technology (“IT”) System Improvements. In WPL I, the STB observed that IT systems change rapidly, with one generation of IT systems being

²⁹ “Learn by doing” productivity is a long-recognized form of productivity. See, e.g., K. Arrow, The Economic Implications of Learning by Doing, Review of Economic Studies, Vol. 29, No. 3 (June 1962) at 155-173. It reflects the basic premise that efficient firms learn how to become more productive over time

³⁰ Observation of WFA/Basin operations expert Paul Smith.

³¹ See “UP orders 113 more locomotive remote control systems” Railway Age (Apr. 1, 2004), Workpapers Vol. 11, pp. 6201-6202; “Data, experience prove remote control (RCL) locomotive technology...” Association of American Railroads Press Release (Nov. 2003), Workpapers Vol. 11, pp. 6203-6204.

replaced by better, more efficient next generation systems. See id. at 106. The LRR, like the SARR in WPL I, can and will replace its current IT system, when it makes economic sense to do so, with even more efficient systems, as these systems become available.

- Track-Related Efficiencies. The railroad industry is continually studying ways to reduce stress on, and increase the operating life of, track and roadbed infrastructure. Published reports indicate the AAR is currently studying:

- Use of new top of the rail lubricators and friction control systems that ease track stress (and increase locomotive fuel efficiencies);³²
- Use of new wayside detection systems that identify poorly performing rolling equipment that could alter track structure and increase wear and tear of track structure;³³
- Improvements in welds used in continuously welded rail in tracks;³⁴
- New synthetic tie materials that will provide increased strength and longer life;³⁵
- Improved methods to treat wood ties which increase tie life;³⁶

³² See Tom Judge, "A sm-o-o-th ride: lubrication in its various forms...." Railway Age (Dec. 2004), Workpapers Vol. 11, pp. 6205-6207; TTCI Annual Report 2002, supra, at 4, Workpapers Vol. 11, p. 6136.

³³ See Marybeth Luczak, "Going by the wayside...." Railway Age (Jan. 2005) at 64-66, Workpapers Vol. 11, pp. 6208-6210; TTCI Annual Report 2002, supra, at 4-5, Workpapers Vol. 11, pp. 6136-6137.

³⁴ See TTCI Annual Report 2002, supra, at 6, Workpapers Vol. 11, pp. 6138.

³⁵ See id.

³⁶ See Terry L. Ambugey, et al., "Extending the Service Life of Wooden Crossties by using pre- and supplemental preservative treatment" Workpapers Vol. 11, pp. 6211-

- Improved bridge joints to decrease degradation of bridge components.³⁷

The LRR, like any rail carrier, will incorporate new, cost-effective track-related materials and procedures as they become available.

iii. Productivity Quantification

In recent SAC cases, complainant shippers have asked the Board to adjust SARR operating costs using the RCAF-A and defendant carriers have asked the Board to adjust SARR operating costs using the RCAF-U. Given the choice between the RCAF-A and the RCAF-U, the Board has chosen the RCAF-U because the Board believes the RCAF-A overstates SARR productivity more than the RCAF-U understates it.³⁸

WFA/Basin present the Board with a new and different choice here. WFA/Basin ask the Board to adjust SARR operating expenses by a factor equal to 0.53% of the forecasted changes in the RCAF-U ("0.53 RCAF-U"). As shown in Exhibit III-G-1, the "0.53 RCAF-U" is a forecast {

} Application of the 0.53 RCAF-U is appropriate here for several interrelated reasons.

First, adopting a middle ground-approach is fully consistent with basic principles of rate regulation. As one court has observed: "the rough splitting of a

6220.

³⁷ See TTCI Annual Report 2002, supra at 6, Workpapers Vol. 11, p. 6138.

³⁸ See TPMA at 161; Duke/NS I at 36-37; Duke/NS II at 15-19; CPL at 27-28; Duke/CSX at 29-30; Xcel I at 32-34.

difference between two fairly but not wholly satisfactory rate calculations is a familiar permissible technique.”³⁹ Similarly, a leading commentator on rate regulation states:

An agency that is satisfied that opposing views are both well supported in the record may adopt the midpoint between the parties’ positions as a reasonable resolution of the matter.⁴⁰

Numerous federal and state agencies have applied the “split the difference” approach when appropriate under the circumstances.⁴¹

Here, the Board has taken the position that the RCAF-A overstates productivity and the RCAF-U understates it. In the absence of any empirical evidence to the contrary, using the 0.53 RCAF-U produces a fair result: the SARR operating costs contain a modest productivity adjustment, {

}

Second, use of the 0.53 RCAF-U conforms to common sense. At the start of its operations, and running through the 20 year DCF period, the LRR should enjoy the productivity gains referenced in the previous section (i.e., use of more efficient locomotives, more efficient rail cars, more efficient train sizes, more efficient operating

³⁹ Ass’n of Am. Publishers, Inc. v. The Governors of the United States Postal Serv., 485 F.2d 768, 773 (D.C. Cir. 1973).

⁴⁰ L.S. Goodman, I The Process of Ratemaking (1998) at 128.

⁴¹ See e.g., Ass’n of Am. Publishers Inc. v. United States Postal Service, 485 F.2d 768, 773 (D.C. Cir. 1973) (Postal Service); Nat’l Cable Television Ass’n v. Copyright Royalty Tribunal, 724 F.2d 176, 186-87 (D.C. Cir. 1983) (Copyright Royalty Tribunal); In re Consumers Power Co., 122 PUR 4th 486, 514-15 (1991) (Michigan Public Service Commission); In re Midwest Gas, 161 PUR 4th 426, 432 (1995) (Iowa Utilities Board).

systems, more efficient maintenance procedures, increased labor productivity, traffic based productivity, IT system improvements and track-related efficiencies).

What makes no sense is to continue to adjust LRR operating costs using the RCAF-U. The RCAF-U contains no productivity adjustment. Use of the RCAF-U assumes that LRR will not enjoy any of the productivity gains the LRR is sure to experience. Indeed, the LRR would soon fall behind BNSF in many efficiency categories. The LRR in many ways simply mirrors current BNSF and UP PRB unit train operations. For example, both BNSF and LRS employ (for the most part), the same locomotive types, the same locomotive consists, the same car types, the same train lengths, the same train lading weights, similar operating procedures, etc. BNSF, and its PRB counterpart, the UP, are constantly working to improve their PRB operations and make them more productive. The LRR would do the same.

Third, use of the 0.53 RCAF-U index is consistent with the Board's findings and ruling in WPL I. The WPL I case, like the present case, involved a challenge by a PRB coal shipper to the coal rates published by a major PRB carrier (UP). The shipper in WPL I, Wisconsin Power & Light Company ("WPL"), modeled a SARR that carried coal from the PRB. In WPL I, the Board was given the choice to adjust SARR operating costs using the RCAF-U forecast (the defendant UP's proposal) or by a fixed annual rate of 1.5% annually (WPL's proposal). WPL's 1.5% annual adjustor was predicated upon an internal UP forecast, produced to WPL in discovery, that "predicted

UP's costs for transporting coal will increase by 1.5% annually through 2022."⁴²

The choice was a consequential one. The WPL I decision states that UP's RCAF-U forecast projected SARR operating costs that would increase "twice as fast"⁴³ as WPL's proposal, indicating that UP's RCAF-U forecast was projecting annual increases in the 3% range. The STB chose the 1.5% adjustment factor, not the higher 3% RCAF-U factor. The Board did so because it found that the 1.5% factor produced a more accurate forecast of the WPL SARR's operating costs. The Board's decision states in pertinent part:

A forecast of future costs based on the RCAF-U – an historic index of costs for the entire rail industry – does not necessarily reflect the cost increases that a single carrier could expect to incur in providing service for a specific commodity. The inflation index in UP's business forecast, in contrast, related specifically to coal movements in the [SARR] traffic group and, therefore, should produce more reliable projections than the more broad-based RCAF-U.

Id. at 106.

The facts in the WPL I case closely parallel the facts in this case. The LRR and the WPL SARR are designed to be efficient railroads that carry a single commodity – PRB coal – in unit train service to utility destinations. It is reasonable to assume – in the

⁴² WPL I at 106.

⁴³ Id.

absence of any better evidence⁴⁴ – that the UP coal cost forecast the STB relied upon in WPL I is equally applicable to BNSF coal service. The vast majority of coal traffic on both the BNSF and UP is PRB unit train coal traffic;⁴⁵ this traffic moves under a comparable cost structure;⁴⁶ and the traffic on each railroad should expect to see similar market-driven productivity improvements over time, particularly since BNSF and UP compete in many instances for the same pool of utility customers. Given these clear factual parallels, WFA/Basin's use of the 0.53 RCAF-U – which produces operating expense increases of approximately { } annually – is fully supported by the Board's use of the 1.5% annual adjustment factor in WPL I.

Fourth, application of the 0.53 RCAF-U conservatively assumes that some of the productivity gains factored into the LRR rates are factored into the LRR's costs. WFA/Basin forecast LRR revenues using adjustment procedures that assume productivity-deflated rates. For example, the EIA AEO 2005 rate projections WFA/Basin utilize to forecast many LRR rates are productivity-deflated, on average, by 3.9% per year. The 0.53 RCAF-U modestly utilizes only a { } average annual productivity deflator to adjust the LRR's operating costs.⁴⁷

⁴⁴ WFA/Basin requested BNSF to produce a similar coal cost forecast in this case. See WFA/Basin RFP No. 98 (served Oct. 20, 2004). BNSF replied that it maintained no such forecasts. See BNSF Response to RFP 98 (served Nov. 19, 2004). See Workpapers Vol. 11, pp. 6221-6224.

⁴⁵ See BNSF Railway Company 2004 Form 10-K at 9 and Union Pacific 2003 Analyst Fact Book at 18.

⁴⁶ Exhibit III-G-2 provides a representative example of the comparable cost structure.

⁴⁷ See electronic workpaper file "RCAF with EIA Productivity.xls."

To further illustrate the conservative results produced by the 0.53 RCAF-U, WFA/Basin have developed a modified RCAF-A that substitutes EIA's productivity forecasts for Global Insight's RCAF-A productivity forecasts (the "RCAF-EIA"). This procedure is explained in detail in Exhibit III-G-3. As shown in Exhibit III-G-3, and summarized in Table III-G-2, below, WFA/Basin's 0.53 RCAF-U index {

}

TABLE III-G-3
Comparison of Indices of the RCAF-U, .53RCAF-U,
RCAF-A and RCAF-EIA Forecasts

Quarter	Index Forecasts				Productivity Factors		
	RCAF-U 1/ (1)	.53RCAF-U 2/ (2)	RCAF-A 1/ (3)	RCAF-EIA 3/ (4)	.53RCAF-U 4/ (5)	RCAF-A 5/ (6)	RCAF-EIA 6/ (7)
1. 4Q2004							1.00
2. 2005							1.03
3. 2006							1.07
4. 2007							1.11
5. 2008							1.15
6. 2009							1.20
7. 2010							1.25
8. 2011							1.30
9. 2012							1.35
10. 2013							1.40
11. 2014							1.46
12. 2015							1.52
13. 2016							1.58
14. 2017							1.64
15. 2018							1.71
16. 2019							1.78
17. 2020							1.85
18. 2021							1.92
19. 2022							1.99
20. 2023							2.04
21. 2024							2.08
22. Geometric Annual Average							3.9%

1/ Historic RCAF data is used through 2Q 2005. Global Insight forecast data from December 2004 is used thereafter.

2/ Reflects the average of the growth rates in Column (2) and Column (4).

3/ Reflects EIA forecast of railroad productivity for western coal shipments.

4/ Column (2) ÷ Column (3).

5/ Column (2) ÷ Column (4).

6/ Column (2) ÷ Column (5).

Fifth, one of WFA/Basin's witnesses is Dr. Douglas W. Caves. Dr. Caves was a principal sponsor of the RCAF-A methodology the ICC adopted in 1989.⁴⁸ Dr. Caves has reviewed the Board's recent decisions discussing SARR productivity and the evidence submitted here by WFA/Basin. Dr. Caves endorses without reservation the use of the 0.53 RCAF-U index as a reasonable – indeed conservative – forecast of productivity-adjusted LRR operating costs.

3. Federal and State Income Tax Liabilities

The LRR is subject to federal taxes. The LRR pays federal income taxes at the corporate rate of 35%, with payments for debt interest, depreciation expenses and non taxes treated as deductibles. This approach complies with governing Board precedents. See FMC at 178-82; WTU at 714. The State of Wyoming does not have an income tax.

4. Other – Capital Cost Recovery

WFA/Basin calculate LRR capital cost recovery using DCF model procedures the Board has approved in several recent cases.⁴⁹ The Board's DCF methodology uses economic depreciation to calculate the capital recovery of the SARR's property. The value of a SARR asset at any point in time equals the discounted present value of the earnings that it will produce over its remaining useful life. Here, as in prior cases, a twenty year DCF period is used to benchmark the SARR's asset values. The DCF methodology recognizes that a SARR will replace assets as they wear out and the

⁴⁸ See Railroad Cost Recovery Procedures – Productivity Adjustment, 5 I.C.C.2d 434, 435 n.4 (1989).

⁴⁹ See e.g., FMC at 178-82, WPL I at 105-07, TMPA at 159-62 and Xcel I at 32-36.

EXHIBIT
III-G-1
REDACTED

EXHIBIT
III-G-2
REDACTED

EXHIBIT
III-G-3
REDACTED

EXHIBIT 3B

WFA/BASIN'S REBUTTAL EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

INDEXING OF SARR OPERATING EXPENSES

index, WFA/Basin utilize EIA's most recent GDP/IPD forecast.¹⁷ Similar procedures and forecasts have been relied upon by the STB in prior cases.¹⁸

On Rebuttal, WFA/Basin continue to rely on these forecasts, as updated to include the most recent forecasts available at the time the rebuttal evidence is filed.

WFA/Basin discuss BNSF's revenue projection procedures in Part III-A-3 above.

d. Operating Expenses

In their opening evidence, WFA/Basin adjusted LRR operating expenses by a factor equal to 0.53% of the forecasted changes in the RCAF-U ("0.53 RCAF-U"). The 0.53 RCAF-U {

}.¹⁹

On Reply, BNSF utilized more recent Global Insight RCAF-A and RCAF-U forecasts produced in March, 2005.²⁰ Subsequent to BNSF's Reply, Global Insight issued an updated RCAF-A and RCAF-U forecast in June, 2005. WFA/Basin rely upon the more current June, 2005 forecast in their Rebuttal with the results shown in Rebuttal Exhibit III-G-1. {

¹⁷ EIA's most recent GDP/IPD forecast is included in Rebuttal electronic workpaper "LRR Traffic and Revenues _ WFABasin Rebuttal.xls."

¹⁸ See, e.g., Xcel I at 34 ("Board prefers impartial forecasts of future inflation").

¹⁹ See WFA/Basin Op. Narr. at III-G-14.

²⁰ See WFA/Basin Rebuttal Exhibits III-G-1.

} On Rebuttal,

WFA/Basin substitute a 0.59 RCAF-U index for the 0.53 RCAF-U index.²¹ Application of the 0.59 RCAF-U index produces an annual average increase in LRR's operating costs of { }. This average is {

}.²² The

0.59 RCAF-U index contains an annual average productivity factor of { }.²³

On Reply, BNSF objects to WFA/Basin's reliance on the 0.59 RCAF-U. BNSF argues that 0.59 RCAF-U overstates projected LRR productivity gains. BNSF opines that the LRR will enjoy no productivity gains until 2014, and thereafter will enjoy only marginal productivity improvements.²⁴

BNSF asks the Board to adjust all LRR operating expenses by the RCAF-U until 3Q 2014. After 3Q 2014, BNSF asks the Board to continue to adjust approximately 75% of the LRR operating expenses using the RCAF-U, with the remaining 25% adjusted

²¹ For each citation, WFA/Basin's Rebuttal will refer to the 0.59 RCAF-U index exclusively.

²² See WFA/Basin Rebuttal electronic workpaper "Exhibit III-G-1 p.1-2.xls."

²³ {

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²⁴ See BNSF Reply Narr. at III.G-3 to 17.

using a “hybrid” RCAF-U/RCAF-A index.²⁵ For ease of reference, BNSF’s indexing procedure is referred to herein as the “BNSF Index”.

Application of the BNSF Index produces an annual average increase in the LRR’s operating cost of { }. The BNSF Index contains an annual average productivity factor of 0 through 4Q2014 and thereafter an annual average productivity factor of { }.²⁶ This results in a composite annual average productivity factor of { } during the twenty-year DCF period.²⁷

The parties’ differing forecasts of operating costs significantly impact the DCF results. For example, WFA/Basin projects the LRR’s 2005 operating costs will increase by \$50.3 million over the twenty-year DCF period. This increase factors in WFA/Basin’s use of the 0.59 RCAF-U index. If the BNSF Index is substituted for the 0.59 RCAF-U index, WFA/Basin’s projected operating costs would increase by \$74.4 million over the twenty-year DCF period – an increase of 48%.

The Board should utilize the 0.59 RCAF-U, not the BNSF Index, because the 0.59 RCAF-U is conservative; is more accurate than the BNSF Index; comports with the WRPI experience; is consistent with the results of the Board’s WPL decision; better correlates the LRR’s productivity-adjusted rates with the LRR’s productivity adjusted

²⁵ See BNSF Reply Narr. at III.G-13 to 17; BNSF Reply Exhibit III.H-1.xls, sheet “operating SAC.”

²⁶ See WFA/Basin Rebuttal electronic workpaper “Productivity.xls.”

²⁷ Id.

operating costs; and is supported by one of the nation's leading experts in rail productivity – Dr. Douglas W. Caves.

**i. The 0.59 RCAF-U is a
Conservative Forecast**

As WFA/Basin discussed in their opening evidence, in several recent maximum rate cases the complainant shippers have asked the Board to adjust SARR operating costs using the RCAF-A and defendant carriers have asked the Board to adjust SARR operating costs using the RCAF-U. Given the choice between the RCAF-A and RCAF-U, the Board has chosen the RCAF-U because the Board believes the RCAF-A overstates SARR productivity more than the RCAF-U understates it.²⁸

In these cases, the Board has expressed concerns that the RCAF-A may overstate SARR productivity gains because an efficient SARR's initial cost structure captures some efficiencies that the railroad industry has yet to achieve.²⁹ On the other hand, the Board has repeatedly recognized that application of the RCAF-U would understate SARR productivity gains since a SARR "built today would realize future productivity gains."³⁰

The 0.59 RCAF-U index responds to the Board's concerns. The 0.59 RCAF-U index provides that, over the 20 year DCF period, the LRR will obtain

²⁸ See Xcel I at 34; Xcel II at 15-16; CPL at 28; TMPA I at 161.

²⁹ See e.g. Xcel I at 33-34.

³⁰ See WPL I at 106.

productivity improvements {

}. This approach factors in the productivity “head start” the Board attributes to the LRR, while also forecasting modest productivity gains for the LRR.

The 0.59 RCAF-U index is even more conservative when measured against the EIA’s PRB forecasts. EIA projects that western carriers will pass-through productivity gains of 4.0% annually³¹ – gains that {

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ii. The 0.59 RCAF-U Index is More Accurate than the BNSF Index

On Reply, BNSF argues that the 0.59 RCAF-U index vastly overstates LRR productivity gains. According to BNSF, the LRR will achieve all of its productivity “up front;” will enjoy no productivity gains for the next ten years; and then will enjoy only tiny productivity gains thereafter.³² The BNSF Index is intended to capture and apply these assumptions.

BNSF is correct that in some ways the LRR is more efficient than BNSF. This is because the LRR removes some inefficiencies in the BNSF’s current PRB operations, including revamping BNSF’s inefficient crew districts; removing inefficient work rules; eliminating current BNSF inefficiencies created by its shared use of the

³¹ See WFA/Basin Rebuttal electronic workpaper “EIA Productivity.xls.”

³² See BNSF Reply Narr. at III.G-3 to 17.

BNSF/UP PRB Joint Line; and modifying BNSF's physical plant to remove inefficient switching and train handling procedures.³³

However, BNSF is incorrect when it asserts that removing some inefficiencies in BNSF's current-operations means that the LRR will not enjoy significant productivity gains. It will.

(a) Sources of LRR Productivity Gains.

WFA/Basin's opening evidence identified over 30 specific areas of forecasted productivity improvements in LRR unit coal train operations.³⁴ The cited productivity improvements were based on unit coal train productivity improvement

³³ While the LRR removes some inefficiencies in BNSF's operations, BNSF's attempts to quantify these differences are so misguided that they require a brief response. At page III.G-8 of its Reply Narrative, BNSF calculates the asserted BNSF's "fully allocated" cost for providing LRR service at \$194.2 million. BNSF then calculates the LRR's 2005 Base Year operating expenses (\$169 million) and asserts the difference (\$25.2 million or 13%) equals the LRR's "productivity" advantage.

Productivity is measured by comparing changes in outputs (e.g., ton miles) with changes in input (e.g., factors used to produce outputs). BNSF's quantification has nothing to do with productivity, and certainly does not provide any quantification of the differences in projected future productivity gains the BNSF and the LRR will experience.

BNSF's costing analysis is also flawed. BNSF's "fully allocated" cost figure is based on BNSF's "2004 URCS system-average variable costs adjusted to remove depreciation and lease expenses and return of road property investment costs and converted to the full cost level using the URCS constant Mark-Up ratio of 1.33." BNSF Reply Narr. at III.G-7 n.6. However, BNSF failed to exclude road return total cost and variable cost in the constant cost mark-up ratio. As shown in WFA/Basin Rebuttal Exhibit III-G-2, substitution of the correct Mark-Up ratio revises BNSF's fully allocated cost calculation from \$194.2 million to \$170.2 million and the so-called "productivity percentage" to 0.7%.

³⁴ See WFA/Basin Op. Narr. at III-G-7 to 14.

measures being studied or tested by the rail industry. The areas of productivity cover the gamut of unit train rail operations, including more efficient locomotives, more efficient railcars, more efficient train sizes, more efficient train operating systems, more efficient maintenance procedures, more efficient deployment of labor, more efficient Information Technology (“IT”) systems, and more efficient use of physical plant through traffic-based efficiencies.

BNSF does not dispute – because it cannot – that it, along with other major coal-hauling railroads, is actively studying and continually implementing measures to increase unit coal train productivity. Instead, BNSF identifies the twelve categories of operating costs shown in DCF Table K. BNSF proceeds to argue on a category-by-category basis why the LRR will achieve no productivity for most expense categories or only minor productivity gains (after 3Q2014) for others.³⁵

The basic problem with BNSF’s “category-by-category” discussion is that it ignores the multiple causative factors that drive railroad productivity improvement. For example, introduction of higher capacity rail cars can generate productivity over several rail expense categories – including railroad equipment costs, reduced labor costs, reduced fuel costs, reduced administration costs, etc.

³⁵ See BNSF Reply Narr. at III-G-13 to 17.

The STB's predecessor, the ICC, properly defined railroad productivity as "aggregate [railroad] output divided by aggregate [railroad] input."³⁶ The RCAF-A applies and quantifies this definition of productivity. As described by the ICC:

productivity [under the RCAF-A is] measured as the change in the ratio of the output index (based on a composite, revenue-weighted, average of the year-to-year changes in ton-miles for various segments of traffic in the ICC Waybill Sample) over the input index (as measured by total freight expenses calculated using depreciation accounting, plus fixed charges).

Railroad Cost Recovery Procedures – Productivity Adjustment, 5 I.C.C. 2d 434, 435 (1989) ("Productivity Adjustment").

As a practical matter, the Board could never craft an RCAF-A index if one of the requirements was to pinpoint the exact causes of rail productivity growth. Identifying the exact causes for historical railroad productivity changes – i.e., the reasons explaining the relationships between change in rail outputs and inputs – is a complex econometric exercise. Nor is it necessary to do so. As the ICC observed in its decision adopting the RCAF-A, "while the exact cause of productivity growth may have intrinsic interest, it is not genuine to the issue of cost recovery."³⁷

³⁶ See Productivity Adjustment – Implementation, 9 I.C.C.2d 1072, 1072 n.1 (1993).

³⁷ See Productivity Adjustment, 5 I.C.C.2d at 465.

The SARR productivity issue, properly framed, is whether it is reasonable to assume that a Class I railroad like the LRR will enjoy modest productivity gains (as reflected in the 0.59 RCAF-U) or virtually no productivity gains (as reflected in the BNSF Index). The record evidence clearly supports the use of the former.

- Traffic-Based Productivity. BNSF argues that the LRR would start out “void of any excess or obsolete plant.”³⁸ However, that is not the case. The LRR is designed and modeled to handle its peak-week traffic – traffic levels that the LRR will not achieve until 2024. Each year of the DCF period, the LRR should enjoy productivity growth brought on by economies of density.

As the Board observed in the Guidelines, “railroads exhibit significant economies of scope and density.” See id. at 526. These economies “refer[] to the fact that the greater use of fixed plant results in declining average cost.”³⁹ Inclusion of a productivity adjustment permits the LRR to enjoy benefits of density productivity on operating costs items that are considered to be a function of tons shipped.⁴⁰

Similarly, the LRR train cycle times are modeled to equal the cycle times the LRR would experience in its peak week of its peak traffic year (2024). As a practical

³⁸ See BNSF Reply Narr. at III.G-6.

³⁹ Id.

⁴⁰ These items are: train/engine personnel; locomotive lease expenses; locomotive maintenance expenses; locomotive operating expenses; rail car lease expenses; loss/damage; insurance; and maintenance-of-way expenses.

matter, the efficient LRR will be able to achieve faster cycles – particularly during its earlier years – when the traffic levels on the LRR are much lighter than they will be in the peak year. For example, in 2005, the LRR will transport 14.6 billion ton-miles of traffic.⁴¹ By 2024, this traffic will be 16.0 billion ton-miles – an increase of 9.6%.⁴²

As the Board has correctly observed, “(cycle time) is a prime measure of a railroad’s efficiency and an important determination of its personnel and equipment requirements.”⁴³ The LRR should enjoy significant productivity gains as a result of its excess capacity – and faster cycle times – particularly during its early years of operation.

- Trainset Productivity. The LRR should also enjoy substantial equipment-based productivity through the 20 year DCF period. This productivity will include use of higher capacity cars and longer trains.

BNSF reports that it has obtained significant productivity gains in its PRB coal service by increasing net tons per train.⁴⁴ Years ago, PRB trains were predominantly 100 ton steel cars, with average lengths of 110 to 115 cars.⁴⁵ Today, PRB trains are

⁴¹ See WFA/Basin Rebuttal electronic workpaper “LRR Traffic and Revenues_WFABasinRebuttal.xls.”

⁴² Id.

⁴³ TMPA I at 73.

⁴⁴ See BNSF Presentation, Financial Analysts’ Day (Nov. 13, 2003) at slide “Coal Train Set Productivity” (WFA/Basin Rebuttal electronic workpaper “financialanalysts.pdf.”)

⁴⁵ Id.

predominantly 120 ton aluminum cars, and average train length has increased to 125-135 cars.⁴⁶

BNSF projects "continued productivity improvements" in trainset performance in the future.⁴⁷ The LRR will incorporate these trainset productivity improvements as well.

These improvements will come through continuing incremental changes in car capacities (e.g. substituting aluminum cars for steel cars) and incremental increases in train lengths up to current industry standard maximums (136 cars), as well as through introduction of the next generation of coal cars (e.g., 315,000 gross-weight-on-rail cars)⁴⁸ and substantially longer train sizes (e.g., UP is now testing 200-250 car coal trains).⁴⁹

Most of the cars used for the LRR's coal traffic are supplied by shippers.⁵⁰ BNSF argues that the LRR will not have the physical capacity to handle longer train or heavier trains. That is not true. The LRR's train line has double-track over most of its route. All LRR sidings are located in areas where they can be extended, as necessary, to

⁴⁶ See BNSF Presentation, Deutsche Bank Global Transportation Conference (Feb. 16, 2005) at 12 ("Deutsche Bank") (WFA/Basin Rebuttal electronic workpaper "DeutscheBank.pdf.")

⁴⁷ Id. at 13.

⁴⁸ See WFA/Basin Op. Narr. at III-G-8 to 9.

⁴⁹ Id. at III-G-9 to 10.

⁵⁰ See BNSF Reply electronic "LRR Traffic and Revenues_WFABasin Opening_BNSFRivisedMSP.xls."

handle longer trains.⁵¹ Also, the LRR can – and will – make the necessary investments to upgrade its facilities as necessary to handle longer trains for the same reason BNSF will – the upgraded facilities will reduce service costs.

- Train/Engine Personnel. BNSF argues that due to the LRR's asserted extremely high level of utilization, there is little room for future "productivity improvement."⁵² However, as noted above, the LRR – particularly in its early years of operation – does not maximize utilization of its system. Faster cycle times in the early years of LRR should lead to significant reduction in the number of train and engine personnel needed.

In addition, projected continued productivity in all other areas of the LRR's operations (e.g., increased net train loadings, introduction of new dispatching technologies,⁵³ introduction of new locomotives, etc.) will also result in reductions in the number of train and engine personnel hours.

BNSF also states in its Reply that one-person crews "might some day be possible" but it "is too speculative at this time to be considered a realistic source of

⁵¹ Many of the LRR's passing sidings are two train-lengths long. These sidings are already long enough to accommodate 250-car trains, or they can easily be extended to accommodate two single trains.

⁵² See BNSF Reply Narr. at III.G-7.

⁵³ See WFA/Basin Rebuttal electronic workpaper "dispatching technologies.pdf" for descriptions of new dispatching technologies that are being introduced.

productivity improvement for the LRR.”⁵⁴ Recent reports indicate otherwise – with a focal point being the introduction of one-person crews on PRB coal trains.

BNSF has already instituted one man-person service on PRB helper locomotives.⁵⁵ And, UP CEO Dick Davidson recently announced that UP is “ready to immediately begin using one-person crews” in PRB coal service.⁵⁶ What is currently holding up carriers from expanding one man train crews are union work rules – work rules that do not apply to the LRR.

- Locomotive Lease Expense. BNSF argues that the LRR will be locked into using SD70 MAC locomotives for the next twenty years.⁵⁷ Thus, under BNSF’s world view, the LRR will not be able to utilize more productive locomotives as they enter the marketplace.

In their opening evidence, WFA/Basin showed that, over the course of ten years, WRPI/UP turned over its principal locomotive fleet three times (going from SD40's to C-40-8's to C44-9W's).⁵⁸ Each generation of locomotives was more productive than

⁵⁴ See BNSF Reply Narr. at III.G-13 to 14.

⁵⁵ See Don Geiger, “Rolling with Change,” Railway Age (May/June 2004), WFA/Basin Rebuttal electronic workpaper “singlecrews.pdf.”

⁵⁶ See “Union Pacific considers a train crew of one” Omaha World-Herald, Sept. 1, 2005. WFA/Basin Rebuttal electronic workpaper “UPtraincrew.pdf.”

⁵⁷ See BNSF Reply Narr. at III.G-10 to 11.

⁵⁸ See WFA/Basin Op. Narr. at III-G-6.

the last. The new locomotives substantially reduced WRPI's costs since they are more powerful and more fuel efficient, thus decreasing WRPI's locomotive costs per car.⁵⁹

BNSF maintains that the LRR will not be able to do the same because the LRR has acquired its SD70 MAC's under a long-term 22 year lease.⁶⁰ BNSF overstates its case. WFA/Basin utilized a recent BNSF locomotive lease (with a 22 year term) to obtain a representative current market lease rate for SD70 MAC's. The LRR did not enter into this lease, and in any case, the lease in question applies to BNSF's lease of 5 SD70 MAC's – not the entire LRR fleet.⁶¹

Moreover, even assuming that the LRR did lease all of the SD-70 MAC locomotives under the BNSF lease in question, this lease – like most locomotive leases – allows the lessee carrier to assign the lease or terminate it by selling the locomotives in question to a third party.⁶² BNSF speculates that the sale process may involve a “financial penalty” but any such “penalty” turns on whether the sales price obtained for the units are

⁵⁹ Id. at III-G-7 to 8.

⁶⁰ See BNSF Reply Narr. at III.G-14.

⁶¹ See WFA/Basin electronic workpaper “LRR Loco Lease Reb.xls” and WFA/Basin Op. Workpapers, Vol. 7, pp. 4448-4451. BNSF does not address the fact that each year the LRR adds new locomotives that it also leases. See WFA/Basin electronic workpaper “Exhibit_III-H-1.xls.”

⁶² See WFA/Basin Rebuttal electronic workpaper “SD70MAC Lease Termination.pdf.”

less than the specified amounts set forth in the contract.⁶³ If these minimums are obtained (or exceeded), there is no penalty.

In addition, WFA/Basin Witnesses Paul Reistrup and Richard McDonald confirm that it is common practice among locomotive manufacturers/lessors to facilitate railroad/lessees in "trading up" from one generation of locomotive to the next. The lessor benefits from leasing new equipment (and obtaining higher rents per locomotive) while the lessee carrier benefits by obtaining new more productive locomotive units that reduce its unit costs. For example, Mr. McDonald testifies that when he was in charge of operating WRPI, the locomotive manufacturers permitted CNW/WRPI to replace existing locomotives with newer, more efficient models during the terms of existing leases. In particular, GE allowed CNW/WRPI to switch from first-generation C40-8 locomotives to later-model "Dash 8s" and then to AC4400-9 locomotives several times in the late 1980's and early 1990's. There was an additional charge for this, but it was more than offset by the efficiencies (higher horsepower and tractive effort, meaning more tons could be pulled per locomotive,⁶⁴ and better fuel efficiency) produced by the newer models. GE was always able, when requested, to reassign the older model leased locomotives to other customers. Mr. Reistrup confirms that locomotive vendors have always cooperated with railroads in such locomotive swaps so that the railroads can benefit from technological

⁶³ Id.

⁶⁴ For hauling heavy unit trains, improvements in tractive effort (pulling power), combined with new radial trucks, are more important than increases in horsepower.

advances, and that this includes agreeing to revisions in existing leases to accommodate them.

BNSF also opines that WFA/Basin have included no "costs" in the DCF model for new locomotives.⁶⁵ However, BNSF introduces no evidence on what it believes the LRR's projected new locomotive rental payments would be or why these payments would be higher than WFA/Basin's projection of its 4Q04 inflation-adjusted lease payment rates.

BNSF also appears to confuse "price" and "cost" here. Price refers to the price a railroad pays for inputs (e.g., lease payments). Cost refers to outputs (e.g. lease payments per revenue ton-mile). WFA/Basin's new lease payment prices may – or may not – be higher than its inflation-adjusted 4Q04 lease payments. However, that is not the proper inquiry. The inquiry for productivity purposes is whether acquisition of the new locomotives will reduce the LRR's overall service costs. BNSF and other carriers (including WRPI) have been able to substantially reduce their overall costs by substituting more productive locomotives when these locomotives become available in the marketplace. The LRR will do the same.

- Locomotive Maintenance Expense. In their opening evidence, WFA/Basin identified various technologies and methodologies the railroad industry is

⁶⁵ See BNSF Reply Narr. at III.G-10 to 11.

now studying to reduce locomotive maintenance expenses.⁶⁶ On Reply, BNSF “concedes” that the LRR will experience productivity in its maintenance practices but claims the productivity “will likely be offset by additional maintenance costs as the LRR locomotive fleet ages.”⁶⁷ BNSF offers no evidence in support of this statement.

Improved procedures to reduce locomotive maintenance expenses will reduce the LRR’s maintenance costs – regardless of the age of the locomotive. BNSF’s assertions here also assume the LRR will retain the same fleet for the entire DCF period. This assertion is wrong for the reasons discussed above. BNSF also ignores productivity gains in other areas (e.g., incorporation of high net loadings per train, lower cycle times, improved railroad communications systems, introduction of electric-pneumatic braking, and other factors) that will reduce locomotive maintenance expenses on a unit basis.

- Locomotive Operating Expense. BNSF opines that the LRR will experience no productivity gains in operating its locomotives “[b]ecause the LRR traffic patterns remain relatively consistent over the 20-year DCF period and the locomotive fleet remains unchanged.”⁶⁸ BNSF’s assertions are wrong for the reasons discussed above. The LRR should experience lower cycle times (and reduced operating expenses) – particularly in its early years of operation which will directly translate into lower

⁶⁶ See WFA/Basin Op. Narr. at III.G-10 to 11.

⁶⁷ See BNSF Reply Narr. at III.G-14.

⁶⁸ Id.

locomotive operating expenses. Also, BNSF erroneously assumes that the LRR will be locked into its initial SD70MAC fleet for the next twenty years.

- Railcar Leases. WFA/Basin modeled the LRR using BNSF's (and its customers') current coal car fleets.⁶⁹ WFA/Basin also predicated their 4Q04 base period car lease costs on lease rates BNSF is now paying for rental of similar coal cars. As with locomotives, BNSF assumes that over the next 20 years the LRR will be locked into the 2004 composition of its car fleet.

Twenty years ago BNSF's car fleet consisted principally of 100 ton (or less) steel railcars. Today, the fleet is primarily 120-ton aluminum railcars – reflecting advances in car technology over the last 20 years. As WFA/Basin described in their opening evidence, the railroad industry continues to look at ways to increase car capacity. BNSF's assumption that the LRR will keep the same car fleet over the next 20 years is absurd – BNSF need only look to the changing compositions of its own coal car fleet over time as proof.

BNSF also opines here, as it did with locomotives, that WFA/Basin want the benefits of car productivity (brought on by more higher capacity efficient cars) without paying for it. The answer is the same here. WFA/Basin's DCF model inflates LRR's operating costs by { } annually. BNSF has introduced no evidence showing the projected new car costs would be higher than WFA/Basin's projected adjusted car

⁶⁹ See WFA/Basin Op. Narr. at III-C-21 to 23.

lease rate. Even more significantly, BNSF has made no demonstration that the LRR's overall costs would not be decreased by substituting more efficient rail cars.

- Materials and Supplies. BNSF "concedes" that the LRR will experience productivity gains due to "technological improvement[s]" commencing in 2014.⁷⁰ BNSF offers no evidence, but only speculates that "technological improvement" would not exist prior to 2014.⁷¹ BNSF also fails to acknowledge that material and supply unit costs will decrease due to many factors – including reduced cycle times, more efficient train sizes, etc.

- Ad Valorem Taxes. BNSF projects no productivity improvements that impact ad valorem taxes.⁷² BNSF offers no evidence, however, that application of the 0.59 RCAF-U index will not cover the LRR's ad valorem tax obligations during the 20 year DCF period.

- Operating Managers. BNSF argues that the LRR will enjoy no productivity gains at the operating manager level. Again, BNSF is wrong. The LRR is modeled assuming an operating staff level needed for its peak year operations in 2024. As an efficient operation, the LRR would certainly find ways to reduce staffing levels – particularly in its early years when its traffic levels are lower.

⁷⁰ See BNSF Reply Narr. at III.G-15 to 16.

⁷¹ Id.

⁷² Id. at III.G-15.

For example, 62 of the 104 operating manager positions the LRR models for its peak-week operations are equipment inspectors.⁷³ The number of equipment inspectors is tied to the number of trains being inspected. In its early years of operations, the LRR will need fewer train inspectors because it has fewer trains to inspect. Also, introducing train operation efficiencies over time (e.g., longer trains, more-efficient locomotives, etc.), will reduce the number of locomotives and trains that the LRR will need to inspect – which will also reduce the number of equipment inspector employees the LRR will need to add.

- General & Administrative. BNSF concedes the LRR's G&A expenses "would likely benefit from technological improvements."⁷⁴ However BNSF arbitrarily dictates that the LRR will obtain no such improvements until the 11th year of its operation. On Opening, WFA/Basin identified numerous technology innovations the rail industry now has under study.⁷⁵ These new technologies are not ten years away from being implemented. Indeed, ten years from now these new technologies may be themselves obsolete. The LRR – like any rail carrier – will be continually seeking better ways to run its business – starting on day one of its operations.

⁷³ See WFA/Basin Rebuttal electronic workpaper "LRR Operating Expenses Reb.xls."

⁷⁴ See BNSF Reply Narr. at III.G-16.

⁷⁵ See WFA/Basin Op. Narr. at III-G-7 to 14.

- Loss and Damage. BNSF claims that the LRR will accrue no loss and damage claims productivity.⁷⁶ However, the LRR should enjoy productivity improvements over time for loss and damage claims since the total number of coal cars in its system should be reduced (e.g., through use of higher capacity cars). Also, the rail industry is constantly studying new technologies, and procedures, to operate in a safer fashion.⁷⁷ Loss and damage claims should be reduced, over time, on a per unit basis as a result.

- Insurance. The DCF model sets insurance payments as a percentage of other operating expenses. Therefore, productivity improvements in the LRR will automatically be reflected in the DCF insurance payment calculation.

- Maintenance-of-Way. In its opening evidence, WFA/Basin identified numerous technologies and procedures in the railroad industry in studying – and testing – to improve direct state-of-the-art maintenance procedures.⁷⁸ BNSF concedes that the LRR will enjoy productivity improvements in its maintenance practices but BNSF again arbitrarily claims that the productivity improvement will not start until

⁷⁶ See BNSF Reply Narr. at III-G-16.

⁷⁷ See WFA/Basin Rebuttal electronic workpaper “carsafety.pdf” for a review of developments and initiatives to improve rail car safety.

⁷⁸ See WFA/Basin Rebuttal electronic workpaper “LRR Operating Expenses Reb.xls.”

4Q14. However, many of the technologies and procedures now under study are now being fully tested – and should be available very soon to the LRR and other carriers.⁷⁹

(b) Proper Productivity Calculation.

BNSF's narrative explanation deliberately, and substantially, understates LRR productivity gains. As a consequence, the BNSF Index – which is modeled on BNSF's productivity assumptions – substantially understates LRR productivity gains.

Unlike BNSF, WFA/Basin's narrative evidence provides a realistic picture of forecasted LRR productivity gains over time. The 0.59 RCAF-U index – which is modeled to incorporate WFA/Basin's reasonable LRR productivity forecasts – provides a reasonable, conservative estimate of LRR productivity improvements. WFA/Basin's productivity estimations are far more credible than BNSF's.

BNSF also opines that WFA/Basin have not “tied” their productivity estimates to the DCF model.⁸⁰ BNSF appears to argue that the only way for WFA/Basin to factor productivity gains into the DCF model is to start inputting anticipated, specific productivity-driven unit cost changes into its calculations (e.g., assuming in year X an exact different locomotive mix, car mix, etc.).

⁷⁹ See, e.g., Marybeth Luczak, “Going by the wayside,” Railway Age (Jan. 2005) at 64, contained at WFA/Basin Rebuttal electronic workpaper “MOW Initiatives,” which describes new systems for increasing the efficiency of MOW planning through the AAR's “Advanced Technology Safety Initiative.”

⁸⁰ See BNSF Reply Narr. at III.G-9.

SARR modeling is already extraordinarily complex. The level of specification that BNSF apparently is seeking to impose on WFA/Basin would make SARR productivity modeling impossible. The 0.59 RCAF-U index is intended to factor in a reasonable forecast of LRR productivity-adjusted LRR operating costs. This forecast, on an average basis, is intended to provide a realistic measure of LRR operating cost increases. The indexing mechanism itself incorporates anticipated changes in LRR service outputs and inputs (including the prices WFA/Basin will pay for these inputs). Indexing is the appropriate method to account for expected gains. Indexing recognizes that productivity growth is net of costs, and thus avoids the double counting of costs. It also does not require the impossible task of predicting with certainty the timing and sources of productivity gains.

WFA/Basin further observe that BNSF did not make any changes to specific DCF inputs (e.g., adding prices paid for new technology) when it made its proposed productivity adjustments for the LRR's costs.⁸¹ BNSF did not do so for the same reasons WFA/Basin did not do so – it is simply not necessary, nor a viable modeling exercise.

⁸¹ Id. at III.G-16 to 17.

**iii. Use of the 0.59 RCAF-U Comports
with the WRPI Experience**

BNSF's productivity assumptions and its resulting BNSF Index posit an implausible scenario – a supposedly efficient carrier suddenly ceasing to be efficient for the next twenty years. BNSF cites no real-world examples of any carrier start-ups who are similarly frozen in time for the next twenty years. None exist.

As WFA/Basin demonstrated on Opening, even highly efficient start-up carriers can, and do, become more efficient over time.⁸² WFA/Basin pointed to WRPI as a very comparable real world example.⁸³ WRPI started out operations in the mid-1980's as a highly efficient PRB coal carrier. However, WRPI's operations were not frozen at its mid-1980 start-out levels. Instead, WRPI (like BNSF and UP), became substantially more productive over time through traffic growth and through introduction of more productive equipment, more productive train operations, more productive operating procedures, etc.⁸⁴

On Reply, BNSF claims that WRPI's productivity growth is irrelevant because "[t]here is no evidence in the record that the LRR ... resembles the real world WRPI in any meaningful way."⁸⁵ BNSF obviously failed to read the record. WFA/Basin

⁸² See WFA/Basin Op. Narr. at III-G-5 to 7.

⁸³ Id.

⁸⁴ Id.

⁸⁵ See BNSF Reply Narr. at III.G-9.

introduced substantial evidence – which stands unrebutted – that WRPI and the LRR are mirror images of each other. The LRR enters the PRB market in 4Q04 as a short-haul carrier serving PRB mines. The LRR transports the coal in unit train service over short distances and, with the exception of the LRR traffic, interchanges its traffic with a major Class I railroad – the residual BNSF.⁸⁶ WRPI was identical to the LRR in all material respects. WRPI entered into the PRB market in 1984 as a short haul carrier serving PRB mines. WRPI transported this coal in unit train service over short distances and interchanged its traffic with a major Class I railroad – the UP.⁸⁷

BNSF also argues that there is no evidence that WRPI enjoyed a cost advantage over other railroads. Had BNSF checked, it would have found that WRPI did enjoy such an advantage. For example, in 1992, WRPI's operating ratio was 52.2% – well below the operating ratios of all other Class I railroads.⁸⁸

**iv. Use of the 0.59 RCAF-U Complies
with the Board's WPL Ruling**

As WFA/Basin demonstrated on opening, the use of the 0.59 RCAF-U is supported by the Board's decision in WPL. In WPL, the Board adjusted the WPL

⁸⁶ See WFA/Basin Op.Narr. at III-B-2.

⁸⁷ See WFA/Basin Op. Exhibit III-A-3, p.2, 9.

⁸⁸ See 1992 Chicago and Northwestern Annual Report to Shareholders at 2, copy in WFA/Basin Rebuttal electronic workpaper "CNW 1992 Annual Report.pdf." In 1992, operating ratios for other Class I carriers ranged from 80.65% for UP to 108.57% for the Soo Line. See 1992 Analysis of Class I Railroads (copy in WFA/Basin Rebuttal electronic workpaper "1992 Operating Ratios.pdf").

SARR's operating costs by 1.5% annually – a percentage similar to the percentage change produced in application of the 0.59 RCAF-U { } annually.⁸⁹

The Board predicated its 1.5% factor increase on an internal UP forecast. That forecast projected UP coal train costs to adjust upward at 1.5% annually.⁹⁰ In their opening evidence, WFA/Basin demonstrated that the UP coal train cost forecast the STB relied upon in WPL I is equally applicable to BNSF coal service in this case because the vast majority of coal traffic on both the BNSF and UP is PRB unit train coal traffic, this traffic moves under comparable cost structures, and BNSF and UP compete in many instances for the same pool of utility customers.⁹¹ Given these market similarities, the BNSF and UP coal traffic should share similar market-driven productivity improvements over time.

BNSF's reply evidence demonstrates that the { } annual increase WFA/Basin uses is conservative. In its reply evidence, the BNSF forecasted its anticipated PRB unit train cost changes. This forecast is included as part of BNSF's avoidable cost divisions analysis. Significantly, BNSF projected these cost changes as

⁸⁹ UP also projected in WPL that the RCAF-U would increase at 3% annually. Thus, the UP's 1.5% increase factor contained a productivity adjustment of approximately 1.47% ($1.03 \div 1.015$).

⁹⁰ See WPL I at 106.

⁹¹ See WFA/Basin Op. Narr. at III-G-16 to 18.

equaling the changes measured by Global Insight's forecast of the RCAF-A.⁹² This forecasts shows rail costs changing at { } annually.⁹³

**v. Application of the 0.59 RCAF-U
Provides a Better Fit with the
Productivity-Adjusted LRR Rates**

WFA/Basin forecast LRR revenues using adjustment procedures that assume productivity-deflated rates. For example, the EIA AEO 2005 rate projections WFA/Basin utilize to forecast many LRR rates are productivity-deflated, on average, by 4.0% per year.⁹⁴ The 0.59 RCAF-U modestly utilizes only a { } average annual productivity deflator to adjust the LRR's operating costs.⁹⁵

As WFA/Basin demonstrated on Opening, use of the 0.59 RCAF-U conservatively assumes that a small fraction { } of the productivity pass-through assumed in the LRR rate structure (4.0%) is in fact captured in the LRR cost structure. The BNSF Index, on the other hand, assumes virtually no meaningful inclusion of productivity in the LRR cost structure – thereby substantially overstating the LRR's costs, and substantially understating the revenue differential between the LRR's revenues and its costs.

⁹² See BNSF Reply electronic workpaper "LRR Traffic and Revenues _ WFABasinOpen_BNSF Revised.xls."

⁹³ Id.

⁹⁴ See WFA/Basin Rebuttal electronic workpaper "EIA Productivity.xls."

⁹⁵ See WFA/Basin Rebuttal electronic workpaper "EIA Productivity.xls."

vi. Dr. Caves Endorses the 0.59 RCAF-U

WFA/Basin's LRR productivity evidence is sponsored in part by, and endorsed by, Dr. Douglas W. Caves. Dr. Caves is one of the nation's leading experts on rail productivity. As WFA/Basin stated on opening, "Dr. Caves endorses without reservation the use of the 0.53 RCAF-U index as a reasonable – indeed conservative – forecast of productivity adjusted LRR operating costs."⁹⁶

In the 1980's, the ICC was faced with a difficult decision – how to quantify rail industry productivity gains. Dr. Caves, along with his colleague Dr. Christensen, sponsored a new, creative means to solve the ICC's problem. The ICC went on to adopt the Caves/Christensen productivity approach – an approach the Board continues to rely on in making its RCAF-A calculations.⁹⁷

The Board is faced here with a task the Board finds difficult – forecasting future productivity for the SARR's. WFA/Basin has developed a creative approach to resolving this problem – the 0.59 RCAF-U – an approach Dr. Caves endorses without reservation. BNSF argues that Dr. Caves' views are entitled to "no weight."⁹⁸ In fact, it is BNSF's trumped up productivity discussion that is entitled to no weight. BNSF's SARR productivity discussion is not sponsored by any witness with any nationally

⁹⁶ See WFA/Basin Op. Narr. at III-G-21.

⁹⁷ See Productivity Adjustment, 5 I.C.C.2d 434 (1989).

⁹⁸ See BNSF Reply Narr. at III.G-6.

recognized experience in rail productivity matters. This stands in sharp contrast to WFA/Basin's evidence. Indeed, it is difficult to tell from BNSF's Reply filing whether any of its witnesses sponsored BNSF's discussion of productivity issues. In any event, none of BNSF's witnesses are nationally recognized experts in rail productivity matters. Dr. Caves is such an expert. His opinions are entitled to substantial weight.

3. **Tax Liability**

BNSF accepts WFA/Basin's determination of the LRR's tax liabilities.

4. **Asset Lives**

BNSF accepts the asset life assumptions used by WFA/Basin with one exception. BNSF contends that a portion of the LRR would be constructed with concrete ties, which have a longer average life than wood ties.⁹⁹ BNSF's contention is incorrect. As WFA/Basin's Opening workpapers clearly show, the LRR was constructed utilizing only wood ties.¹⁰⁰ WFA/Basin based its Opening asset life of 19 years for wood ties on the average depreciation rates for ties included in Schedule 332 of BNSF's 2004 Annual Report R-1.¹⁰¹ However, this asset life reflects the average life of both wood and concrete ties used on the BNSF system. To reflect only the asset life of wood ties in its rebuttal

⁹⁹ Id. at III.G-18.

¹⁰⁰ See WFA/Basin Opening electronic workpaper "Track Quantities.xls."

¹⁰¹ See WFA/Basin Opening electronic workpaper "Exhibit_III-H-1.xls."

evidence, WFA/Basin rely upon BNSF's Reply workpapers to develop an average asset life for wood ties of { } years.¹⁰²

5. Other – Capital Cost Recovery

a. Change of the Board's Debt Amortization Procedures

In its opening evidence, WFA/Basin amortized debt issued by the LRR over the estimated assets lives of the assets acquired with the debt.¹⁰³ BNSF in Reply asserts that WFA/Basin improperly deviated from the STB's precedent of using a 20-year amortization schedule, and has provided no proof that the LRR could obtain debt-financing with maturities of greater than 20 years.¹⁰⁴ Both of BNSF's assertions are incorrect.

With regard to WFA/Basin's supposed deviation from the STB's "standard" 20-year amortization schedule, there is nothing "standard" about the DCF-model's 20-year period. The 20-year DCF period is in-fact arbitrary and has no attachment to real world financing. The ICC settled on a 20-year DCF model because that was the time frame selected by the shipper in McCarty Farms.¹⁰⁵ In Nevada Power, the ICC used a 25-year DCF model because, once again, that was the time period selected by the shipper,

¹⁰² See WFA/Basin Rebuttal electronic workpaper "Exhibit_III-H-1.xls."

¹⁰³ See WFA/Basin Opening Narr. at III-H-4.

¹⁰⁴ See BNSF Reply Narr. at III.G-19.

¹⁰⁵ See id. at 469.

Exhibit III-G-1

Redacted

Exhibit III-G-2

Redacted