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BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. NOR 42054

PPL MONTANA, LLC,

Complainant,

v.

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY,

Defendant.

PETITION OF PPL MONTANA, LLC FOR RECONSIDERATION

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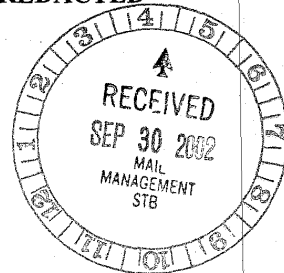
SEP 30 2002

SURFACE
TRANSPORTATION BOARD

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Dated: September 30, 2002



PREFACE AND SUMMARY OF ARGUMENT

Complainant PPL Montana, LLC ("PPL") seeks reconsideration of the Board's August 20, 2002 Decision pursuant to 49 C.F.R. § 1115.3. See also McCarty Farms v. BNSE, 3 S.T.B. 102, 103 (1998).

The Board found defendant, The Burlington Northern and Santa Fe Railway Company ("BNSF"), market dominant in this proceeding. Accordingly, the challenged rates are required to be reasonable. 49 U.S.C. § 10701(d). However, the Board denied relief. The basis for denying relief was not that the challenged rates are low. In fact, BNSF conceded that its rates exceed the jurisdictional threshold, and PPL showed that the rates produce r/vc ratios more than double the 180% threshold of STB jurisdiction.

This r/vc evidence was not considered because the Board regarded PPL's SARR as fatally flawed. Specifically, the Board looked at one segment of the SARR in isolation, calculated costs and revenues for that segment, and found a \$9.6 million net shortfall in revenues over the 20-year stand-alone period. The Board held that this segment analysis demonstrates the existence of a cross-subsidy of the "western" segment by shippers in the stand-alone group whose freight travels only over the "north-south" segment.

Implicit in the Board's finding (though nowhere stated in the Decision) is the conclusion that, assessed as a unitary rail system, the SARR designed by PPL generates system revenues which are more than adequate to cover system costs. In all prior rate cases, this conclusion would have led the Board to grant relief.

The Board's segmented stand-alone cost ("segmented SAC") test is a new test, not previously applied as the basis for denying relief in any rate case. Because the

Board's analysis was unexpected and has little or no support in the record of this proceeding, PPL asked two of its expert witnesses, Mr. Thomas D. Crowley and Dr. George Borts, to assess the Decision and the Board's basis for denying relief. Their Verified Statements are filed herewith.

Mr. Crowley was able to identify three instances of clear material error in the Board's application of segmented SAC to this case, despite the vagueness of the Board's new approach. First, the Board assumed that a lighter density segment requires as extensive a level of investment in equipment as a more dense segment. In addition, the Board's calculations failed to take into account differences between PPL's opening and rebuttal evidence in calculating costs.

Finally, the Board assumed that PPL had maximized the tonnage over the "western" segment of its SARR. In fact, millions of tons of coal that BNSF routes over that segment were rerouted over the north-south segment in PPL's rebuttal statement, on the basis of erroneous claims in BNSF's Reply regarding actual routings. PPL accepted BNSF's erroneous claims to avoid dispute* and because, under established SAC precedent, they would not have altered the outcome of the case. Circumstances changed when the Board adopted the segmented SAC approach after the close of the record in this proceeding, and denied relief based on erroneous findings as to western segment traffic volumes. Correctly routed, these volumes lead to a different result.

The test for reconsideration set forth at 49 C.F.R. § 1115.3(b) is plainly met. If the Board needs more explanation than is possible in the available space (which the Board declined to expand), it can and should reopen the proceeding for further

* The Board should not penalize shippers for going along with railroad factual claims that do not appear to have a material effect on ultimate conclusions. Avoiding unnecessary disputes benefits all concerned.

evidentiary submissions. Correction of these errors of implementation eliminates the segment shortfall identified in the Board's decision, and PPL is therefore entitled to relief.

Implementation issues aside, the Board's decision raises procedural and substantive issues. Because segmented SAC is a new test, the Board should have explained its departure from past precedent. Atchison, T. & S.F. Ry. Co. v Wichita Board of Trade, 412 US 800, 809 (1973). In addition, PPL should have been provided notice and an opportunity to meet the test. The Board should also have clarified such fundamental issues as how segmentation works and how it can be reconciled with an unbroken line of case law treating SARRs as unitary systems that must cover the movements to which the challenged rates apply.

Segmented SAC is also objectionable as a limit on grouping for which there is no support in the statute or case law. It can prevent the development of least costly, most efficient competitors to market dominant railroads, particularly by shippers on branch lines. In addition, it makes assumptions about the behavior of members of the stand-alone group that are unrealistic, in order to permit unlawful pricing by railroads as to the issue traffic, which is the only traffic subject to STB rate reasonableness jurisdiction. Reconsideration is also warranted to address these issues.

PETITION OF PPL MONTANA, LLC FOR RECONSIDERATION

ARGUMENT

STB regulations provide for reconsideration due to changed circumstances or material error. Both tests have been met here.

The Board's August 20, 2002 Decision in this proceeding does not acknowledge that segmented SAC is a new test. At page 9 of its Decision, the Board cites three decisions in support of segmented SAC: Coal Rate Guidelines, 1 I.C.C. 2d 520 (1985), AEPCO v. BNSF, Docket No. 42058 (decision served December 31, 2001), and PPL v. BNSF (decision served November 27, 2001). The AEPCO and PPL decisions cannot constitute notice to PPL of the segmented standard it would be required to meet. Those decisions were issued long after the May 7, 2001 close of the record in this case.

In AEPCO, the Board said that "revenues from non-issue traffic should not be relied upon to pay for portions of a SAC system over which that non-issue traffic would not move." However, aside from being untimely, the Board's discussion in AEPCO of such alleged cross-subsidies does not apply to PPL. It appears from the Board's description of the AEPCO SARR that separate lines of track connecting separate mine origins with the destination were contemplated. The question of whether such a SARR can be considered a unitary system does not arise in this proceeding. PPL's SARR involves a continuous line of the type treated as a unitary system in all prior SAC decisions.

The November 27 PPL decision could not have put PPL on notice that its SARR would have to be self-sustaining on a segment-by-segment basis even if the Board had announced the applicability of the new AEPCO rule to the PPL case. As noted, the decision was issued too late. In addition, the November 27 PPL decision (which actually ad-

dressed four rate cases, including AEPCO and PPL) did not indicate that the issue of applying revenues from non-issue traffic to unused lines arises in this case. Rather, that issue was described as raised in AEPCO. The cross-subsidization issue in PPL was described as involving the allocation of revenues from cross-over traffic as between BNSF and PPL's SARR. November 27 decision at 7. That cross-over traffic issue was discussed in the Board's August 20 PPL decision, but was not the basis for the Board's denial of relief. The suggestion that PPL should have known that the Board would apply segmented SAC based on decisions after the record closed, which ascribed that issue to the AEPCO case but not to this one, is untenable.

Nor is Coal Rate Guidelines authority for segmented SAC. Coal Rate Guidelines is the source of the SAC test, but segmentation of systems, to the extent mentioned at all, is opposed, as Dr. Borts points out in the attached statement. Such segmentation would not be consistent with the ICC's recognition that the SARR should be the "least costly, most efficient plant," taking advantage of "economies of density" and "adding other profitable traffic" with "no ... restrictions on the traffic that may potentially be included in a stand-alone group" beyond that the grouping be credible. 1 I.C.C. 2d at 543-44.

Where more than one captive shipper is in the stand-alone group, Coal Rate Guidelines merely calls for allocation of the stand-alone cost on Ramsey pricing principles, for which market-based pricing is seen as a surrogate. As the Commission put it, "we think it reasonable and practical to assume that the revenue contribution of other (i.e., non-complaining) shippers will be at the level of their current rates." 1 I.C.C. 2d at 544. PPL adhered to these principles in designing its SARR.

Subsequent ICC and STB decisions applying the SAC constraint pursuant to Coal Rate Guidelines have consistently analyzed SARRs as unitary systems. The agency's focus has always been on the issue traffic, and whether the challenged rate is excessive because the complainant is paying for facilities it does not use. Indeed, the ICC and Board regularly begin their decisions with a capsule summary of how SAC works.¹ Each of these summaries states generally that the process involves estimating the total revenues generated by the traffic served by the SARR, and that where total revenues exceed the total costs of the SARR, relief is in order.

In none of these summaries, and in none of the decisions they introduce (prior to PPL), has the ICC or Board ever indicated that the analysis should be conducted on a segment-by-segment basis, to determine whether shippers other than the complainant are paying more than their attributable costs on a portion of the SARR. On the contrary, the ICC and Board have on many occasions rejected segmentation.²

PPL expects BNSF to argue, notwithstanding this history, that segmented stand-alone is an established test. Any such arguments must be rejected. In its Joint Motion for Limited Consolidation, filed in this and three other coal rate cases on July 5, 2001 ("Joint Motion"), BNSF admitted that, in arguing for a prohibition against cross-subsidization of issue traffic by other members of the stand-alone group, it was urging the Board to make

¹ See, e.g., WTU v. BNSF, 1 S.T.B. 638, 655-56 (1996); McCarty Farms v. BNSF, 2 S.T.B. 460, 466-67 (1997); and WP&L v. BNSF, decision served September 13, 2001, slip op. at 12-13.

² In Metropolitan Edison v. Conrail, 5 I.C.C. 2d 385, 424-5 (1989), the ICC rejected Met Ed's attempt at segmentation, stating "there is only one underlying SARR, and it includes investments and expenses incurred by all the traffic.... [s]egmentation of revenue/SAC comparisons by origins violates the SAC test requirement that actual total revenues be compared with the total SAC for the hypothetical railroad." In McCarty Farms v. BNSF, 4 I.C.C. 2d 262, 270 (1988), the Board noted "BN fails to acknowledge that segments of its traffic base are fully compensatory and therefore, should be examined to determine whether such traffic's inclusion in the stand-alone system would benefit McCarty.... Profitable traffic should be included in the group to lower the average cost of operation." See also Nevada Power, 6 I.C.C.

new law. PPL incorporates by reference herein its August 24, 2001 Reply to that Joint Motion.

At page 20 of the Joint Motion, BNSF argued that a complainant may not include non-issue traffic in a stand-alone railroad network if that traffic shares no facilities with the issue traffic. (Note that this was not a call for segmentation.) BNSF cited no authority, and conceded that it was raising "a question that the case law does not address." BNSF went on to argue that cases involving an incidental sharing of facilities, e.g., yard facilities or a few miles of mainline, should be treated the same as cases involving no shared facilities. (This was apparently a reference to AEPCO, since shared facilities on PPL's SARR are extensive.) More to the point, however, is BNSF's statement at pp. 21-22:

"There exist, however, no procedural or substantive standards to ensure that non-issue traffic has been included in a SAC presentation for legitimate reasons, i.e., to capture legitimate economies of density, and not for the purpose of creating a cross-subsidy."

BNSF then cross referenced its Witness Hausman, who noted, at 14-15, that Coal Rate Guidelines and its progeny establish "no limits, guidance or procedures to ... check that the non-issue traffic is not itself subsidizing the issue traffic". (Emphasis in original.) BNSF concluded by saying "we believe guidance from the Board on this issue is needed." Plainly, BNSF understood that it was asking the STB to modify the stand-alone cost test.

2d 1, 44 (1989): "The SARR should be able to assemble its shipper group from the universe of all shippers utilizing line segments that are common to both the respondents and the [SARR]."

BNSF's Joint Motion was filed two months after the close of the record in this case, and called for a new approach to SAC cases that still did not amount to a proposal that the Board adopt segmented SAC.

BNSF may argue that it alleged cross-subsidy in the evidence filed before the record closed in this case. But those allegations amounted to arguing for reallocation of revenues from cross-over traffic, as the Board found in its November 27 decision in this docket. In so arguing, BNSF was challenging the modified mileage block proration methodology that it sponsored in McCarty Farms, decision served August 20, 1997 at 7-9. BNSF's subsequent attempts (here and in other cases) to rely instead on the efficient component pricing methodology have consistently been rejected by the Board.³

ICC and STB case law, BNSF's call for new guidance, and the timing (and content) of the AEPCO and PPL decisions issued in late 2001 establish that PPL had no notice that it would be required to satisfy the segmented SAC test.

Administrative agencies may establish new law in adjudicative proceedings, subject to certain requirements. However, it is well established that when an agency "seeks to change a controlling standard of law and have it apply retroactively in an adjudicatory setting, the party before the agency must be given notice and an opportunity to introduce evidence bearing on the new standard." Hatch v. FERC, 654 F.2d 825, 835 (D.C. Cir. 1981); accord, Aero Mayflower Transit Co. v ICC, 699 F.2d 938, 942 (7th Cir. 1983). The Board has accepted this requirement of procedural due process in such decisions as

³ BNSF argued briefly that its own rates on north-south traffic exceed SAC for that traffic, and that this set up a cross-subsidy almost ___ times larger than the \$9.6 million shortfall the Board calculated. Klick/Kent Reply VS at 13-14. However, BNSF's theoretical support for that approach came from its Witness Baumol, whose call for SAC analyses of cross-over traffic the Board rejected. Decision at 10, n. 19. It would be anomalous in the extreme for the Board to regard segmented SAC as established on this basis. BNSF cited no decision in which its approach had been applied.

South-West Railroad Car Parts Co., Docket No. 40073, served December 31, 1996. It should do so again here.

The law alone supports reconsideration and reopening to permit PPL to "introduce evidence bearing on " segmented SAC. In addition, PPL's SARR does, in fact, satisfy the segmented SAC test. In his attached statement, Mr. Thomas Crowley demonstrates material error in the Board's Decision, as well as new (or newly relevant) evidence addressing revenues and costs attributable to the western segment of PPL's SARR. Correcting these errors eliminates the western segment revenue shortfall the Board identified. There was no reason to develop such evidence prior to issuance of the Board's Decision, which changed the law by adopting segmented SAC. The standards for reconsideration and reopening have therefore been met.

The most notable flaw in the Board's analysis involves the erroneous routing of more than ___ million tons of coal away from the western segment, based on a factual misrepresentation in BNSF's reply evidence that was immaterial under established SAC case law. Under Coal Rate Guidelines, complainants have broad flexibility with respect to routing. See, e.g., Metropolitan Edison, *supra*, 5 I.C.C. 2d at 420: "The Guidelines allow for the use of an alternative (hypothetical) route, or even a different mode, such as a coal slurry pipeline, for a SAC model." See also AEPCO, decision served August 20, 2002. If hypothetical routings or reroutings are permissible, there can be no disputing PPL's right to rely on a corrected actual routing for coal over the western segment of its SARR.⁴

⁴ Other changes to obtain relief under segmented SAC would doubtless have been possible if PPL had known the segmented SAC test would be applied, and other options might produce even more relief. Mr. Crowley's statement, however, shows how the test can be met without redesigning the SARR, using facts in the record.

This Petition contains enough information to permit the Board Staff to correct these errors. If more evidence or explanation is needed, the Board should reopen the record to permit PPL to show, in greater detail than is possible in these 20 pages, that it is entitled to relief even under segmented SAC.

The Board's August 20 Decision in this case also raises more fundamental issues as to the validity of the segmented SAC test. Segmented SAC is objectionable, in the first instance, because it is unexplained. If the Board intends to apply this test in all future rate cases, it should clarify its justification and application, so that other captive shippers will be able to determine whether they have any hope of successfully challenging the high rail rates they must pay.

An obvious issue in this regard is how the STB intends to determine what constitutes a segment. Is the Board implying that shippers on branch lines, or at the end of stretches of track that carry only complainants' own freight, will hereafter be barred from receiving the benefit of grouping, and therefore from relief under the stand-alone cost test? If so, a great many captive shippers have just had their rail rates deregulated, in derogation of the Act. This is bad law and bad public policy.

Even captive shippers whose freight never leaves high density main lines will now have to worry about whether variations in density over the course of the main line mean their SARRs will also be found fatally flawed. Litigation costs can be expected to rise dramatically for shippers, since they will not know what may constitute a segment. In contrast, litigation expenses for railroads will fall. Apparently, all they will need to show is that any freight, over any segment, is allegedly cross-subsidized by other stand-

alone group shippers' freight. But there is no good reason for greater restrictions on revenue contributions from cross-over traffic than from local traffic.

The Decision cites PPL Witness Borts as supporting its Decision. In the attached Statement, Dr. Borts explains that the Board has misapplied his theory, and has established new and unjustified barriers to rate relief for captive shippers.

Segmented SAC is inconsistent with the Board's Bottleneck decision, in which shippers were ordered to challenge rates applicable to the entire origin to destination routing, even if there is an absence of market dominance over a portion of the route. The Board's new test also creates a double standard. The Board demands a showing that an arbitrarily selected subset of shippers in the stand-alone group is not cross-subsidizing PPL's SARR, before it will consider whether PPL is cross-subsidizing BNSF. But gouging by PPL's SARR is not the issue here. PPL does not even set rates for SAC group traffic, and if the Board had not segmented the system, rates for all shippers in the SAC group would have been found excessive, with reductions allocable to all. The Board should recognize that a hypothetical competitor would not attract the entire group's freight under these circumstances.

If the Board is saying that revenues from non-issue traffic that exceed stand-alone costs for such traffic cannot be used to fund the overall costs of the SARR, the Board is implicitly finding that rates on such traffic exceed SAC, and are therefore unlawful. The Board refuses to remedy such rates (presumably due to lack of jurisdiction), but cites their existence to deny relief to the captive complainant, whose rates are jurisdictional. This creates a "heads we win, tails you lose" arrangement for market dominant railroads

Contestable market theory does not support such an outcome. See Wisconsin

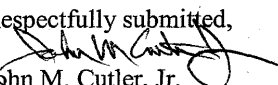
Power Light, supra, decided just two months prior to AEPCO, in September 2001. The UP there argued that WP&L's SARR would, in theory, be subject to competition from yet another stand-alone railroad, creating asymmetric risk. The Board made short work of that argument (decision at 32), observing that because UP does not operate in a contestable market, neither should WP&L's SARR. UP's SAC-based limitation on SARR revenues was rejected as an improper entry barrier. Such entry barriers are inconsistent with stand-alone cost theory.

There is no reason to believe that the western segment would not be constructed and operated by a BNSF competitor like PPL's SARR, taking advantage of the economies of scope afforded by the north-south line. The Board's adoption of segmented SAC is a limit on the ability of captive shippers to design the "least costly, most efficient" hypothetical competitor for market dominant railroads, and maximize profit potential for the SARR. This violates Coal Rate Guidelines and the requirements of the Act.

CONCLUSION

For the foregoing reasons, the Board should grant reconsideration of its August 20 Decision in this proceeding for further consideration of its adoption and implementation of segmented SAC. At a minimum, the Board should allow PPL to show that it is entitled to relief even under that test, reopening the proceeding if necessary to address these issues more fully.

Respectfully submitted,


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Dated: September 30, 2002

VERIFIED STATEMENT OF THOMAS D. CROWLEY

My name is Thomas D. Crowley. I am an economist and President of L.E. Peabody & Associates, Inc. I am the same Thomas D. Crowley that submitted an Opening Verified Statement ("OVS") on December 14, 2000 and a Rebuttal Verified Statement ("RVS") on May 7, 2001 on behalf of PPL Montana, LLC ("PPL") in this proceeding.

On August 20, 2002, the STB served a decision in this proceeding ("Decision") denying relief. The Board based its findings on an analysis concluding that a portion of PPL's SAC traffic group was cross-subsidizing a different portion of PPL's SAC traffic group.¹ The Board indicated that a cross-subsidy arises when traffic would be required to pay for facilities it does not use or when it would be required to pay a portion of costs that are attributable to other traffic (Decision, page 9). The Board found that WMCRR revenues associated with traffic using the Western segment of the WMCRR are not sufficient to cover the operating costs and return on investment that it attributed to this traffic. Therefore, the Board concluded that the traffic which uses the North/South segment exclusively, cross-subsidizes the traffic that uses the Western segment of the WMCRR.

Neither the Board, nor its predecessor the Interstate Commerce Commission, has previously issued a decision in a proceeding using constrained market pricing principles and, specifically, the stand-alone cost test, that segmented a hypothetical stand-alone railroad to determine whether

¹The hypothetical stand-alone railroad in this proceeding is the Wyoming Montana Coal Railroad ("WMCRR"), which extends from Converse Junction, Wyoming north to Donkey Creek, Wyoming and west to Laurel, Montana. The STB segmented the WMCRR into a North/South segment and a Western segment. The North/South segment consisted of the lines extending from Converse Junction, north to Donkey Creek, Wyoming, from Donkey Creek west to Campbell, Wyoming and north from Campbell to Eagle Butte and Buckskin, Wyoming. The Western segment extends from Campbell west to Laurel, Montana and includes the Decker Branch that extends north from a point near Sheridan, Wyoming to the Decker mine.

individual segments of the railroad are self-sustaining, i.e., whether the stand-alone revenues related to traffic moving over a specific segment exceed the associated operating costs and return on investment requirements specific to the segment. As discussed in the accompanying verified statement of Dr. Borts, the Board's new segmented stand-alone analysis violates some of the basic principles of the stand-alone cost test contained in the Guidelines.

I have thoroughly reviewed the Board's Decision and examined the workpapers supporting the Board's analysis. Based on my review, I have determined that the Board made a number of material errors in performing its analysis. My preliminary analysis indicates that correcting for these errors would demonstrate that the Western segment would earn revenues that are greater than the costs attributable to the traffic moving over the Western segment, even under the Board's new segmented approach.

In addition, 8.4 million tons of coal that PPL, in Rebuttal routed only on the North/South segment, is actually moved by BNSF over the Western segment. Had PPL been aware that the Board, for the first time and without notice, would be relying on a cross-subsidy analysis of individual segments of the hypothetical stand-alone railroad in this proceeding, it would have handled this traffic in the same manner as actually moved by BNSF, i.e., it would have routed this additional traffic over the Western segment of the WMCRR. With this traffic routed over the Western segment of the WMCRR, the Western segment would earn revenues greater than its costs.

These material errors, and evidence substantiating this Statement, are discussed below. Space constraints limit my ability to discuss these errors (and others) in detail, but this Statement will demonstrate that relief is in order. If the Board orders the proceeding reopened for further development of these points, PPL's right to relief will be made clearer.

A. THE STB's CROSS-SUBSIDY SEGMENT METHODOLOGY

In the real world or in the hypothetical world of stand-alone costs, cross subsidy is a measure

to determine if the revenues generated by the movement of specific traffic handled by a railroad are greater than or less than the costs² incurred by the railroad to handle that traffic. If revenues are greater than costs, a contribution is made by that traffic to the railroad's fixed costs and profits and the railroad is economically better off handling that traffic than not handling it. On the other hand, if a railroad's revenues generated by a piece of traffic are less than the costs incurred by the railroad to handle the traffic, the traffic is being cross subsidized by revenues from other traffic handled by the railroad. In this situation, the railroad is economically better off without this traffic. In past rate cases, this analysis was done for the SARR as a whole.

In its Decision, the STB segmented the stand-alone group of traffic presented by PPL, created interchange locations between the North/South and Western segments of PPL's SAC group, developed SAC revenues and SAC costs for the two segmented groups through a deductive process based on the traffic information presented by PPL in Rebuttal, and compared the newly developed revenues to the newly developed stand-alone costs of each segmented group. Based on this analysis, the Board concluded that the portion of PPL's SAC group that moves exclusively on the North/South segment was cross subsidizing the portion of PPL's SAC group that moves on the Western segment and dismissed PPL's complaint. To perform its cross-subsidy analysis, the Board considered only three of the four essential elements of a SAC presentation. As discussed below, the Board erred in allocating investment and operating costs, and its analysis of revenues is flawed due to its failure to consider the fourth essential element, i.e., the traffic available to the stand-alone railroad.

**B. MATERIAL ERRORS IN THE BOARD'S APPLICATION
OF ITS CROSS-SUBSIDY ANALYSIS IN THE PPL PROCEEDING**

The Board's cross subsidy analysis contains two substantial errors. First, the Board's

²Direct, attributable, incremental, marginal, variable, etc.

allocation of investment to the Western segment is overstated to the extent that it includes investment for a centralized traffic control system ("CTC") which would not be required if the Western segment is a separate entity and is not integrated with the North/South segment. The Western segment, as presented in PPL's Rebuttal, handles only 25 million tons of coal annually and would require a far less expensive signaling system than a CTC system, such as an Automatic Block System ("ABS").

An error also exists in the STB's calculation of operating expenses attributable to traffic moving on the Western segment of PPL's stand-alone railroad. To calculate the operating expenses for the Western segment the Board relied on a combination of evidence presented by BNSF in Reply and PPL in Rebuttal. In doing so, however, the STB failed to recognize that the BNSF Reply evidence it utilized was based specifically on PPL's Opening evidence and cannot accurately be applied to PPL's Rebuttal evidence.

Specifically, BNSF's Reply used PPL's Opening evidence to calculate the operating expenses associated with traffic that originates on the North/South segment that never utilizes the Western segment of the WMCRR (i.e., traffic that is interchanged to BNSF by the WMCRR at either Donkey Creek or Converse Junction, since the remainder of the traffic on the WMCRR moves on the Western segment).

The Board's approach is in error because it fails to recognize the change that PPL made in routing its traffic between PPL's Opening and Rebuttal evidence. In Rebuttal, PPL changed the routing on approximately ____ million tons of coal originating on the North/South segment that
t e r m i n a t e s a t t h r e e d e s t i n a t i o n s i n
_____, respectively. In Opening, PPL routed this traffic from the Powder River Basin ("PRB") west to Moran Junction to interchange with BNSF. In Rebuttal and in response to BNSF's criticism that this traffic is routed in an

easterly direction, PPL changed the routing on this traffic to interchange with BNSF on the North/South segment at either Donkey Creek or Converse Junction.

Because of the change in the routing of this ____ million tons from moving on the Western segment to moving only on the North/South segment, the percentage of total operating cost attributable to the Western segment in Rebuttal is less than that attributable to the Western segment in Opening, yet the Board failed to recalculate this percentage, thereby overstating the operating cost attributable to the Western segment. The Board's error is shown mathematically in the example contained in Exhibit (TDC - 1) to this Verified Statement.

My preliminary analysis indicates that if the correct percentage had been used, the Board would have determined that revenues from traffic moving over the Western segment would exceed the cost attributable to traffic moving over the segment, satisfying the STB's new segmented cross-subsidy procedures.

**C. THE BOARD CONSIDERED ONLY THREE OF
FOUR ESSENTIAL SAC ELEMENTS IN ITS ANALYSIS**

Although the revenue, operating cost and investment for PPL's stand-alone system were manipulated by the Board in its new segment SAC approach, the traffic group was not. The Board did not attempt to determine if any of the existing traffic group that originated on the North/South segment that was interchanged with the incumbent at Donkey Creek could have been interchanged with BNSF at Moran Jct., MT traversing the entire Western segment.

As indicated previously, PPL rerouted ____ million tons of traffic moving to three destinations because, in its Reply, BNSF indicated that traffic to these three destinations actually moves through Donkey Creek or Converse, rather than on the Western segment as routed by PPL in

Opening.³ At the time PPL prepared its Rebuttal evidence, neither the Board nor the ICC had ever applied a segment analysis to look for a potential cross subsidy in a stand-alone cost proceeding. Further, given the fact the WMCRR revenues exceed the stand alone costs for its entire system, there was no need for this traffic to be routed over the Western segment for PPL to prove its case. PPL was therefore willing to accept BNSF's argument that this traffic should be routed through Donkey Creek or Converse. Had the Board previously used a segment analysis to determine cross subsidy, PPL would have never conceded this previously immaterial point to BNSF.

In fact, BNSF's claim in Reply that traffic destined to these three locations moves through Alliance and does not use the Western segment was not correct. Examination of the data contained in the BNSF traffic tapes provided to PPL in discovery shows that traffic from PRB origins moves to each destination using both routes. Based on the fact that BNSF actually routes a substantial portion of this traffic through Moran Jct., it is appropriate for the WMCRR to move all traffic to these destinations through Moran Junction.⁴ Were this traffic routed over the Western segment, the revenues on the Western segment would exceed the attributable cost, even using the Board's definition of attributable costs.

In addition, other traffic is included in PPL's SAC traffic group that moves to destinations in Wisconsin and Minnesota that could be rerouted over the Western segment. The Board did not attempt to determine if any of the SAC traffic moving on the North/South segment was available for routing on the Western segment, assuming a segment cross-subsidy analysis is applied. As rerouting is not required when the stand-alone system is not segmented, PPL did not evaluate the ability to reroute any of this traffic in its Opening or Rebuttal Evidence. The rerouting of the

³Reply Verified Statement of Rick C. Ellis and Loren E. Mueller, pages 67 and 68 and Exhibit __ (RCE/LEM-7).

⁴BNSF's traffic tapes show that 51% of PRB originated traffic moving to these destinations in the first 6 months of 2000 is routed through Moran Junction. (Source: Electronic Workpaper file coltrn00.dbf supporting Thomas D. Crowley Opening Evidence December 14, 2000. Coltrn00.dbf was developed from BNSF traffic files provided in discovery, bates numbers BNSF/PPL/Tapes 1 thru 12).

incumbent's traffic for use in a SAC analysis is consistent with the recent AEPCO decision and the Guidelines.

If the STB's errors are corrected and the STB properly evaluates PPL's traffic group, the challenged rates will be found unlawful and PPL should receive the relief it requested, even following the Board's new segmented stand-alone approach.

D. CONCLUSIONS

The Board's analysis includes several errors. The corrections above will reverse the conclusion reached in its Decision. In addition, by failing to evaluate the traffic that is available to move over the Western segment, the Board substantially misstated the results of its segment cross-subsidy analysis and came to the wrong conclusion.

VERIFICATION

COMMONWEALTH OF VIRGINIA)
CITY OF ALEXANDRIA)

Thomas D. Crowley, being duly sworn, deposes and say that he has read the forgoing Verified Statement that he knows the contents thereof, and that the same are true as stated to the best of his knowledge, information and belief.


Thomas D. Crowley

Sworn and Subscribed before me
this 30th day of September, 2002

Anthony V. Evanshaw III

My Commission expires: September 30, 2003

**Hypothetical Example of STB's Error in Calculating Operating Costs
Attributable to the WMCRR Western Segment**

A. Base Year Tons by Segment (millions)

Segment (1)	PPL Opening		PPL Rebuttal	
	Tons (2)	Percent (3)	Tons (4)	Percent (5)
1. North/South	127	79.4%	135	84.4%
2. West	33	20.6%	25	15.6%
3. Total	160	100.0%	160	100.0%

**B. BNSF Calculation of Operating Cost for North/South Segment
from PPL Opening Evidence**

Segment (1)	Operating Cost (2)	Percent (3)
1. North/South	\$90.0	60.0%
2. West	60.0	40.0%
3. Total	\$150.0	100.0%

C. STB Calculation of Operating Cost Attributable to Western Segment

Segment (1)	PPL Rebuttal (2)	Percent (3)	STB Calculation (4)
1. North/South	xxx	60.0%	\$84.7
2. West	xxx	40.0%	56.5
3. Total	\$141.2	100.0%	\$141.2

D. Actual Operating Expense

Segment (1)	Opening		\$/Ton (4)	Rebuttal	
	Expense (2)	Tons (3)		Tons (5)	Expense (6)
1. North/South	\$90.0	127	\$0.709	135	\$95.7
2. West	60.0	33	\$1.818	25	45.5
3. Total	\$150.0	160	—	160	\$141.2

E. STB Overstatement in Western Segment Operating Cost

	Amount
1. STB Operating Cost	\$56.5
2. Actual Operating Cost	45.5
3. Overstatement	\$11.0
4. Percent overstatement	24.2%

VERIFIED STATEMENT OF GEORGE H. BORTS

My name is George H. Borts. I am a Professor of Economics at Brown University. My address is 220 Slater Avenue, Providence, Rhode Island, 02906. I have presented evidence before the Board on behalf of PPL Montana, LLC ("PPL") in this proceeding, and my professional qualifications were described in my opening Verified Statement. The purpose of this statement is to comment on the economic issues contained in the Board's Decision, issued August 19, 2002.

I have also read the Verified Statement of PPL witness Thomas D. Crowley, and I agree with its methodology and conclusions. Mr. Crowley has pointed out a fatal error in the Board's calculation of traffic, nullifying the Decision's main conclusion. He has identified other errors as well.

Apart from errors in the underlying calculations, I believe that the Decision is based on a faulty application of the Stand-Alone Cost (SAC) analysis as propounded in the Coal Rate Guidelines and carried out in the Board's earlier decisions. The decision focuses attention on a portion of the SARR's route, not the entire route. The portion in question consists of line segments from Campbell, WY to Laurel, MT, referred to as the western part of the movement. It is a relatively lightly traveled line (approximately 25 million tons per year), connecting to the main trunk line of coal traffic (approximately 150 million tons per year) serving the northern Powder River Basin, and referred to as the north-south part of the movement. The movements to PPL Montana's Corette station on the western line originate at various points on both lines.

The Board compares revenues from traffic that traverses both western and north-south lines with the costs of carrying that traffic, labeled as attributable costs. Such costs are defined to consist of the sum of capital charges, taxes, and operating expenses of the western line plus operating expenses that the western line traffic imposes on the north-south line. Western line revenue does not cover western line costs, as defined above. Since the SARR is profitable, the Board concludes that the western line is subsidized by north-south traffic that does not use the western line. I will refer to the latter traffic as the

non-users of the western line, or non-users for short.¹

The Board's treatment of PPL Montana's SARR differs from the Guidelines, which allows the complainant to configure traffic to make its SARR as profitable as possible. The Guidelines allow the SARR to haul non-issue traffic presently carried by the incumbent, so long as such traffic can be shown to share the facilities used by the issue traffic. Such sharing is encouraged, in order to create economies of scale and scope. Moreover, the Guidelines do not require the SARR's non-issue traffic to use all of the facilities used by the SARR. Nor do the Guidelines indicate any other conditions that would prevent the SARR from including profit earned on non-issue traffic. In the Decision, for the first time, profit from non-issue traffic will be disallowed on the SARR, where the non-users are said to be subsidizing the rest of the SARR's traffic.

The new methodology thus contradicts the Guidelines by establishing conditions precluding the SARR from taking advantage of profits from all available traffic, whereas such profit is in practice available to the incumbent railroads. The SARR is thus disadvantaged financially relative to the incumbent railroad it is designed to emulate.

The rates charged to non-users are not at issue in these proceedings. They should not receive such solicitous attention by the Board, or be treated as if they were being exploited by the SARR. Indeed, under the Guidelines, profit from non-issue traffic is treated exactly as it is treated by the incumbent.

Moreover, the Board's test of cross-subsidy is based on a new definition of attributable cost that is inconsistent with its use in the Guidelines. Under Constrained Market Pricing (CMP) principles, a railroad will add all traffic whose rates exceed its attributable cost, defined in the Guidelines (at 538) as long-run marginal cost.² In contrast, under the Board's definition of attributable cost in the Decision, a railroad might turn away much of the traffic it would willingly carry under CMP.

¹ In his V.S., witness Crowley shows that western line revenue indeed covers its cost, and does not receive a cross-subsidy from non-users.

² The Guidelines treatment of attributable cost is consistent with the Board's decision in Ex Parte 347 (Sub-No. 2), 1 S.T.B. 1004 (1976), where it stated, "As a general rule, it is better for a railroad to carry any traffic that covers its own (attributable) costs and makes any contribution (no matter how slight) to joint and common costs." In contrast, the Decision defines attributable cost to be the sum of total operating and capital costs on one segment plus operating expenses on the other.

The Decision incorrectly suggests (at fn. 18) that it is implementing a definition of cross-subsidy that was employed in my Reb. V.S. My use of the definition is directed to the cross-subsidy of a particular movement of traffic, not the entire volume of traffic on a segment of the SARR. Moreover, my concept of attributable cost is the same as the Board's "long-run marginal cost", which is distinct from its redefinition of an old term.

The treatment of attributable cost in the Decision is a far cry from that of the Guidelines. We know that traffic on PPL Montana's SARR makes a contribution to its joint and common costs, for its revenue exceeds its total costs. What the Board has done is to split the SARR into two divisions in such a way that this contribution disappears from sight. For now the western line is required to stand on its own, and is treated as if it were a distinct SARR of its own.

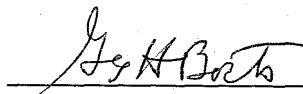
It is hard to see how one can operate a contiguous transportation system if every segment of a railroad is judged on this basis, for it is well recognized that some segments exist to serve others. Indeed, in the Guidelines, the Board explicitly rejected proposals to segment the railroad between low and high density lines for rate making purposes, citing (at 531) the railroads' argument that "a carrier's light and high density lines are inextricably linked and cannot be segregated in the manner suggested."

VERIFICATION

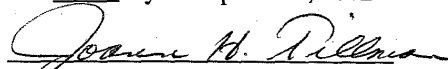
STATE OF RHODE ISLAND)

COUNTY OF PROVIDENCE)

George H. Borts, being duly sworn, deposes and says that he has read the foregoing Verified Statement, that he knows the facts set forth therein, and that the same are true as stated to the best of his knowledge, information, and belief.


George H. Borts

Sworn and Subscribed before me
this 27 day of September, 2002


Notary Public

My Commission expires June 29, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have, this 30th day of September, 2002, caused copies of
this document to be served by messenger delivery on counsel for BNSF as follows:

Samuel M. Sipe, Jr.
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