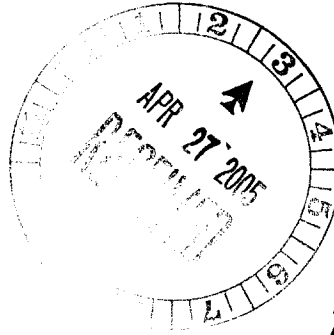


STEPTOE & JOHNSON LLP

ATTORNEYS AT LAW

Anthony J. LaRocca
202.429.8119
alarocca@steptoe.com

1330 Connecticut Avenue, NW
Washington, DC 20036-1795
Tel 202.429.3000
Fax 202.429.3902
steptoe.com



213877

April 27, 2005

Via HAND DELIVERY

Hon. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

PUBLIC VERSION

Re: *Otter Tail Power Company v. BNSF Railway Company*,
Docket No. 42071

ENTERED
Office of Proceedings

APR 27 2005

Part of
Public Record

Dear Secretary Williams:

Enclosed for filing in the above-captioned matter are the original and 15 copies of the Public Version of the Final Brief of Defendant BNSF Railway Company. A copy of the filing is also included in PDF format on the three (3) enclosed CDs.

Please date stamp the extra copy of this cover letter and return it to the messenger who delivered this filing.

Sincerely,

Anthony J. LaRocca

AJL/dwj

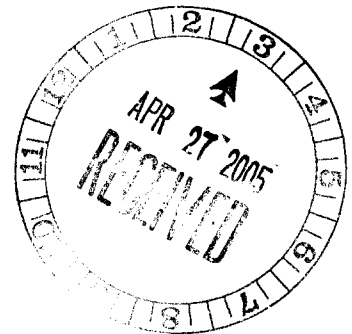
Enclosures:

cc: Counsel for Complainant

PUBLIC VERSION

SURFACE TRANSPORTATION BOARD

STB Docket No. 42071



**OTTER TAIL POWER COMPANY
v.
BNSF RAILWAY COMPANY**

**Final Brief of
BNSF Railway Company**

**ENTERED
Office of Proceedings**

APR 27 2005

**Part of
Public Record**

Richard E. Weicher
Michael E. Roper
David M. Pryor
BNSF RAILWAY COMPANY
2500 Lou Menk Drive
Forth Worth, TX 76131
(817) 352-2353

Samuel M. Sipe, Jr.
Anthony J. LaRocca
Linda S. Stein
STEPTOE & JOHNSON
1330 Connecticut Ave, N.W.
Washington, DC 20036
(202) 429-3000

April 27, 2005

**ATTORNEYS FOR
BNSF RAILWAY COMPANY**

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. OTTER TAIL'S ABUSE OF CROSS-OVER TRAFFIC	4
A. The Board Should Exclude The Southbound PRB Traffic	5
B. The Board Should Modify The Origin Blocks In Its MSP Methodology To Address Distortions Created By The Huge Volume of Short-Haul Traffic	6
C. The Board Has Improperly Rejected The DARA Methodology	9
D. The Board Should Reject Otter Tail's Market-Based Revenue Allocations	10
III. OTTER TAIL'S ABUSE OF REROUTED INTERMODAL TRAFFIC	11
IV. OTTER TAIL'S UNDERSTATEMENT OF YARD-RELATED COSTS	13
V. OTTER TAIL'S UNDERSTATEMENT OF OPERATING COSTS	14
VI. OTTER TAIL'S UNDERSTATEMENT OF CONSTRUCTION COSTS	18
VII. THE BOARD SHOULD REJECT THE DCF CHANGES THAT OTTER TAIL BELATEDLY ASKS THE BOARD TO MAKE	21
VIII. THE <i>PPL</i> CROSS-SUBSIDY TEST SHOULD BE USED TO ENSURE THAT ANY RATE PRESCRIPTION RESULTING FROM THE SAC ANALYSIS IS NOT BASED ON AN IMPERMISSIBLE CROSS-SUBSIDY	23
IX. CONCLUSION	25

ABBREVIATIONS

Terms

AFE	Authority For Expenditure
BNSF	BNSF Railway Company
CARDS	Computer Aided Railway Design System
DARA	Density Adjusted Revenue Allocation
DCF	Discounted Cash Flow
EIA	Energy Information Administration
Evid.	Evidence
Exh.	Exhibit
FEC	Florida East Coast Railway
ICC	Interstate Commerce Commission
LUM	Locomotive Unit Mile
MOW	Maintenance Of Way
MRL	Montana Rail Link
MSP	Modified Straight-Mileage Prorate
Nar.	Narrative
Op.	Opening
OTP	Otter Tail Power Company
Otter Tail	Otter Tail Power Company
OTRR	Otter Tail Railroad
PRB	Powder River Basin
RCAF-A	Rail Cost Adjustment Factor-adjusted for changes in productivity
RCAF-U	Rail Cost Adjusted Factor-unadjusted for changes in productivity
Reb.	Rebuttal

RTC	Rail Traffic Controller
RSAM	Revenue Shortfall Allocation Method
SAC	Stand-Alone Cost
SARR	Stand-Alone Railroad
STB	Surface Transportation Board
Supp.	Supplemental
UP	Union Pacific Railroad Company
URCS	Uniform Rail Costing System
V.S.	Verified Statement
WRPI	Western Railroad Properties, Inc.

Pleadings

BNSF Motion to Strike	BNSF's Motion to Strike (filed Jun. 8, 2004)
BNSF Reply to Otter Tail's First Motion to Compel	BNSF's Reply to Otter Tail's First Motion to Compel (filed May 1, 2002)
Complainant's Reply to Defendant's Motion to Strike	Complainant's Reply to Defendant's Motion to Strike (filed July 20, 2004)

ICC or STB Proceedings

<i>CP&L</i>	<i>Carolina Power and Light Company v. Norfolk Southern Ry. Co.</i> , STB Docket No. 42072 (served Dec. 23, 2003)
<i>December 13, 2004 Decision</i>	<i>Otter Tail Power Co. v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket 42071 (filed Dec. 13, 2004)
<i>Duke/CSX</i>	<i>Duke Energy Corp. v. CSX Transportation, Inc.</i> , STB Docket No. 42070 (served Feb. 4, 2004)
<i>Duke/NS</i>	<i>Duke Energy Corporation v. Norfolk Southern Ry. Co.</i> , STB Docket No. 42069 (served Nov. 6, 2003)

<i>Guidelines</i>	<i>Coal Rate Guidelines: Nationwide</i> , 1 I.C.C.2d 520 (1985)
<i>Nevada Power</i>	<i>Bituminous Coal-Hiawatha, Utah, to Moapa, Nevada</i> , 10 I.C.C.2d 259 (1989)
<i>OPPD</i>	<i>Omaha Public Power Dist. v. The Burlington Northern R.R. Co.</i> , 3 I.C.C.2d 123, 144 (1986).
<i>PPL I</i>	<i>PPL Montana, LLC v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42054 (served Aug. 20, 2002)
<i>PPL II</i>	<i>PPL Montana, LLC v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42054 (served Mar. 21, 2003)
<i>RSAM</i>	<i>Notice</i> , STB Ex Parte Docket No. 347 (Sub-No. 2) <i>Rate Guidelines- Non-Coal Proceedings</i> (served May 21, 2004)
<i>TMPA</i>	<i>Texas Municipal Power Agency v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42056 (served Mar. 24, 2003).
<i>Xcel I</i>	<i>Public Service Company of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42057 (served June 8, 2004).
<i>Xcel II</i>	<i>Public Service Company of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42057 (served Dec. 14, 2004)
<i>Xcel III</i>	<i>Public Service Company of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Ry. Co.</i> , STB Docket No. 42057 (served Jan. 19, 2005)

This is the Final Brief of defendant BNSF Railway Company, filed pursuant to the Board's January 19, 2005 and March 18, 2005 orders in this proceeding.

I. INTRODUCTION

Otter Tail's complaint was the fourth in a series of PRB coal shipper complaints filed between mid-2000 and the beginning of 2002 that challenged rates for BNSF's transportation of coal. All four cases have sought to test the limits of the Board's SAC methodology and to see if the SAC test can be used to bring about steep reductions in coal transportation rates. BNSF's commercial practices are not at issue in these cases. In each case, BNSF offered to enter into a new contract with lower rates when the shipper's pre-existing contract expired. BNSF offered to reduce Otter Tail's prior contract rates by { }. All four shippers rejected BNSF's offer and chose to gamble for even greater rate reductions through regulatory intervention.

These shippers misunderstand or have chosen to ignore the public policies underlying STB regulation of rail rates. Congress instructed the Board to minimize its regulation of rail rates and to allow the market to establish rates for rail transportation to the maximum extent possible. Regulation is supposed to be limited to the protection of shippers from monopoly abuse from market dominant railroads. When regulation is necessary, it is supposed to promote the public's interest in a healthy rail infrastructure. STB regulation was never intended to become a business opportunity to improve shippers' profitability at the expense of revenue inadequate rail carriers.

This case should never have been brought. On a mills/ton-mile basis, the challenged rate falls between the rates prescribed in the recent *Xcel* and *TMPA* cases.¹ Otter Tail admits that its

¹ The challenged rate is also well within the range of rates BNSF charges shippers with inelastic demand. See BNSF Reb. Nar. at I-6 to I-9. As BNSF explained, the basis for this comparison is a workpaper submitted by Otter Tail on reply. Otter Tail's consultants flagrantly

demand is highly inelastic. The record shows that Otter Tail's delivered cost of coal rose sharply in 2002 with no impact on its production of electricity.² In fact, the vast majority of the increase in Otter Tail's delivered cost of coal in 2002 was the direct result of a sharp increase in the unregulated price that Otter Tail pays for the coal itself. Otter Tail is attempting to compensate for higher *unregulated* coal costs resulting from its coal contracting strategy by convincing the Board to reduce BNSF's *regulated* transportation rates. This is a misuse of the regulatory process.

The challenged rate is about 30 percent below BNSF's RSAM level -- the rate target that the Board has determined that BNSF would have to charge on average to shippers whose rates exceed the jurisdictional threshold for BNSF to achieve revenue adequacy.³ Otter Tail argues that the Board should ignore its RSAM calculations because BNSF's revenue inadequacy on a system-wide basis is not relevant in a rate reasonableness case under the SAC test. But the statute expressly instructs the Board to "recogniz[e] the policy . . . that rail carriers shall earn adequate revenues" in determining the reasonableness of rates in individual cases. 49 U.S.C. §10701(d)(2). The Board's statutory obligation to take revenue adequacy into account is not satisfied simply by using the SAC test to assess a complainant's rate reasonableness claims. The Board must ensure that it is applying the SAC standard in a way that gives railroads an opportunity to achieve revenue adequacy through meaningful differential pricing.

manipulated the underlying data to create the appearance that BNSF's rates were out of line with rates charged to other high-demand shippers.

² BNSF's witness Mr. Slater showed that except for maintenance outages, the month-by-month capacity factors for the five years 1998-2002 followed similar patterns regardless of changes in the delivered cost of coal. BNSF Op. Nar. at II-69 to 70.

³ The revenue-to-variable cost ratio for shipments to Otter Tail from the Belle Ayre mine for 1Q03 is 216. See BNSF Reb. Nar. Table I-1. In its most recent determination, the Board established an RSAM of 316 for BNSF. See *RSAM*, Table I.

This case raises three critical issues of SAC methodology. The first involves Otter Tail's heavy use of short-haul cross-over traffic. If the Board accepts the use of cross-over traffic in a SAC presentation, it must find ways to deal with the distortion of SAC results that is produced by short-haul cross-over traffic. As BNSF explains below, a simple and direct way to deal with the problem of short-haul traffic is to modify the origin block in the Board's MSP methodology to reflect more accurately the costs to originate unit coal trains which are far lower than the system-average origination costs reflected in the 100-mile origin block used in the MSP methodology. The second issue involves the validity of Otter Tail's traffic group, which includes a large volume of PRB coal movements that do not share any facilities with the issue traffic. The Board should not allow SAC analyses to be complicated by the inclusion of traffic that does not share the facilities used by the issue traffic. The third issue involves application of the *PPL* cross-subsidy test. If the Board were to reach the stage of prescribing maximum reasonable rates, it should make it clear that the *PPL* cross-subsidy test is applicable not only in testing the reasonableness of the challenged rate but also to ensure that any rate prescription does not reflect an impermissible cross-subsidy.

The Board may not need to address any of these methodological issues in this case, however, because there is a strong likelihood that the Board will dismiss Otter Tail's complaint on the same grounds that it dismissed *PPL*'s complaint. The cross-subsidy analysis presented by Otter Tail in its March 14, 2005 Supplemental Evidence (Errata) shows that even using Otter Tail's understated cost assumptions, the revenues generated by the traffic using the OTRR's east-west facilities exceed the collective attributable costs of that traffic by a relatively small margin. The supposed overcharges calculated by Otter Tail on this traffic would be wiped out by modest changes in Otter Tail's cost assumptions. If, after adjusting Otter Tail's costs to reflect more reasonable SAC assumptions, the Board concludes that the east-west traffic does not generate

revenues that cover its collective attributable costs, the Board should dismiss Otter Tail's complaint without further analysis.

Otter Tail has struggled through more than three years of litigation and numerous iterations of SAC evidence in an effort to support its claim that the challenged rates are unreasonable.⁴ A fair review of the record shows that Otter Tail has failed to support that claim.

II. OTTER TAIL'S ABUSE OF CROSS-OVER TRAFFIC

As in all of the recent SAC cases, the Board in this case must address the complainant's misuse of cross-over traffic. All of the OTRR's traffic, with the sole exception of the issue traffic, is handled as cross-over traffic. Such a heavy reliance on cross-over traffic raises serious concerns about the validity of the traffic group on which Otter Tail's SAC presentation is based. In *OPPD*, the ICC authorized the use of cross-over traffic in the SAC analysis *only* if the complainant showed that the full off-SARR costs of the cross-over movements were covered by the through revenue available from those movements. *OPPD*, 3 I.C.C. 2d 123, 141-144 (1986). Otter Tail has not even attempted to make such a showing here.

The Board has ignored the *OPPD* requirement in recent cases and has allowed extensive use of cross-over traffic by complainants as a "reasonable measure of simplification." *Xcel I* at 16. Simplification is a valid objective, but not if it is a pretext for accepting methodologies that systematically skew the results of the SAC analysis in favor of the complainants. No one has ever refuted BNSF's showing (using a simple "Y" diagram) that cross-over traffic can be used to create an appearance that reasonable rates are unreasonably high. The goal of simplification cannot justify the use of standards that produce demonstrably inaccurate results. BNSF's position on this issue is set out in its Reply Narrative at III.A-6 to 19.

⁴ This case has been pending for more than three years. Therefore, under 49 U.S.C. §11701(c), the proceeding should have been automatically dismissed by force of law.

If the Board allows complainants such open-ended use of cross-over traffic in a SAC presentation, it must address complainants' most obvious manipulations of cross-over traffic. Here, Otter Tail engages in two related gaming strategies that should be disallowed: (1) Otter Tail includes a large volume of cross-over traffic in the OTRR that does not share any facilities with the issue traffic; and (2) Otter Tail allocates revenues to short-haul cross-over traffic that are vastly disproportionate to the work done to originate the traffic.

A. The Board Should Exclude The Southbound PRB Traffic

The Board asserts that cross-over traffic can be used in SAC presentations because it allows "the SAC analysis to focus on the particular facilities and services needed to serve" the complaining shipper. *Xcel I* at 14. Consistent with this rationale, Otter Tail should clearly be prohibited from including in the OTRR traffic group 85 million tons of cross-over traffic that originate at mines from Cordero south and travel south to exit the OTRR at Converse. *See* BNSF Supp. Reply Nar. at III.A-7 to 13. None of the facilities used by these southbound movements is used by the issue traffic. The OTRR as posited by Otter Tail does not originate any issue traffic at mines south of Cordero. Therefore, if the SAC analysis is, as the Board claims, supposed to focus on revenues available to cover the costs of the facilities used by the issue traffic, the SARR in this case should not extend beyond Cordero, the southernmost point at which the issue traffic is assumed to originate, and the southbound traffic originating on this extension of the OTRR should be excluded.

Exclusion of the 85 million tons of southbound traffic is also required by the traffic grouping principles first articulated in the *Guidelines*. As the Board has explained, the *Guidelines* "do not envision that a captive shipper may shift responsibility for paying for facilities it uses to other shippers who do not benefit from those facilities." *PPL II* at 6. The southbound shippers whose traffic originates at Cordero and mines south of Cordero receive no

benefit whatsoever from the facilities used by the issue traffic and they should not be expected to contribute any revenues to offset the cost of those facilities. Otter Tail's belated claim that it may start originating coal from southern PRB mines does not justify including the 85 million southbound tons of coal in the OTRR. Even if Otter Tail uses the Black Thunder mine in the future, 90 percent of the southbound coal traffic that BNSF excluded from the SAC analysis originates at mines from Black Thunder south and therefore would still share no mainline facilities with the issue traffic. *See* BNSF Supp. Evid. Nar. at III.A-25.

Otter Tail's obvious purpose for including this southbound traffic in the OTRR traffic group was to use the revenues from this traffic to subsidize the facilities north of Cordero that are used by the issue traffic. In its December 13, 2004 decision, the Board acknowledged BNSF's concern a subsidy could be created by including this traffic in the OTRR traffic group, but it stated that "it is unclear that the correct remedy would be to exclude the traffic entirely." December 13, 2004 Decision at 2. For the reasons set out above, BNSF continues to urge the Board to exclude this traffic from the SAC analysis. However, if the Board includes the traffic, BNSF demonstrated in its March 1, 2005 Supplemental Evidence how the Board can ensure that the revenues from this traffic are not used to create an impermissible cross-subsidy. *See* BNSF Supp. Evid. Nar. at III.A-19 to 39. The cross-subsidy issue is addressed later in this Brief.

B. The Board Should Modify The Origin Blocks In Its MSP Methodology To Address Distortions Created By The Huge Volume of Short-Haul Traffic

Otter Tail's inclusion in the OTRR of the 85 million tons of southbound PRB traffic was part of a larger strategy to game the SAC results by loading up the OTRR with short-haul cross-over traffic that is assumed to generate revenues vastly in excess of the costs incurred by the OTRR to handle the traffic. One hundred and sixty million tons of the OTRR's base-year coal traffic travel on average only 25 miles on the OTRR. By contrast, the issue traffic moves more than 1000 miles on the OTRR over different lines. *See* BNSF Supp. Evid. Nar. at III.A-21, 25.

Most of the OTRR's short-haul traffic originates at PRB mines on BNSF's Campbell Subdivision (north of Campbell, WY) or at PRB mines south of Cordero, and it exits the OTRR at Donkey Creek or Converse after a very short haul. This traffic uses only the OTRR's north-south lines and it shares few, if any, facilities with the issue traffic.

Nevertheless, Otter Tail assumes that this short-haul traffic contributes an enormous amount of revenue, far out of proportion to the amount of work done by the OTRR to originate it. The 85 million off-at-Converse tons use a tiny portion of the OTRR but using the Board's MSP methodology, they generate 17 percent of the OTRR's total coal revenues. While the OTRR handles this traffic for an average distance of 2 percent of the length of the through movement, the OTRR receives 10 percent of the available through revenues. The OTRR is assumed to receive revenues per net ton-mile for this traffic that are almost *five* times greater than those received by the residual BNSF. *See* BNSF Supp. Evid. Exh. III.A-2. The revenue imbalance on the short-haul traffic is even greater for the off-at-Donkey Creek traffic. The OTRR handles this traffic only 1.6 percent of the average distance of the total movement, but under the Board's MSP methodology, the OTRR claims almost 12 percent of the through revenues. The OTRR receives more than *eight* times the revenues per net ton-mile for this traffic than the residual incumbent. *See* BNSF Supp. Evid. Exh. III.A-3.

The reason for the revenue imbalance on this short-haul traffic is that the Board's MSP methodology overstates the credit for originating unit coal trains. *Eighty-seven* percent of the revenue generated by the off-at-Donkey Creek traffic is attributable *only* to the origin credit. BNSF Supp. Evid. Nar. at III.A-24. When a complainant relies as heavily as Otter Tail on the revenues generated by an origination credit, it is critical for the Board to make that credit as accurate as possible. The Board has made it clear that "the revenue allocation should reflect, to the extent practicable, the defendant carrier's relative costs of providing service over the two

segments.” *Duke/NS* at 20. Therefore, to ensure the accuracy of the origin credit it is necessary to examine the costs involved in originating unit coal trains.

BNSF showed that the 100-mile system-average origin credit is not appropriate for unit coal trains because it is far out of proportion to the costs incurred by a railroad to originate those trains. The Board’s own URCS methodology undermines the validity of the 100-mile origin credit when applied to unit trains. URCS assumes that the costs to originate and terminate unit train carloads in shipper-owned cars is about 25 percent of the cost to originate the system-average carload. Therefore, the origin block assigned to unit coal trains should be 25 percent of the 100-mile origin credit that is applied to the system-average carload. BNSF showed that the use of a 25-mile origin credit (on movements using shipper-supplied cars) is further supported by a movement-specific analysis of the variable costs for the issue traffic movement, which shows that the variable origination costs are the equivalent of about 20 miles of variable line-haul costs. *See BNSF Supp. Reply Exh. III.A-9* at 3.

Otter Tail’s response to BNSF’s evidence on the modified origin credit is confused and difficult to follow. *See OTP Reb. Exh. III-A-13* at 1 to 9. Otter Tail’s principal argument appears to be that short-haul moves have higher per-mile costs than long-haul moves because terminal costs are spread over fewer movement miles. *See id.* at 9. While that assertion may be true, it is not relevant here. The use of a block credit of any size for origination and termination will *always* produce the results that Otter Tail seeks -- short-haul moves with an origination credit will always have higher per-mile costs than long-haul moves since the credit will be spread out over fewer miles on a short-haul move. Indeed, as seen in Table III.A-4 of BNSF’s March 1, 2005 Supp. Evidence, when BNSF’s modified origin block is used, the mill-per-mile rate is still significantly higher for the OTRR’s short-haul moves than for the residual incumbent’s longer-haul move. The question here is not whether to apply a block credit for

originating traffic, but the proper *size* of the origin credit. On that question, Otter Tail is silent. Otter Tail presents no evidence whatsoever that would support the use of a 100-mile origin credit on unit coal trains.

Therefore, if the Board is going to continue to use MSP, it must adjust the origin credit to reflect more accurately the costs to originate unit coal trains. Revenues that would be produced by use of a modified MSP methodology are set out at BNSF Reply to Supp. Evid. Nar. at III.A-5, Table III.A-2.

C. The Board Has Improperly Rejected The DARA Methodology

In its evidentiary filings in this case, BNSF urged the Board to apply the DARA methodology to allocate revenue on cross-over traffic instead of the MSP approach. DARA reflects costs associated with both the length of haul and the relative density of the two segments of a cross-over movement and it is therefore the best approximation of the relative costs of the on-SARR and off-SARR portions of a cross-over movement. DARA first ensures that the SARR and the residual incumbent receive revenues sufficient to cover the variable costs of each segment of the movement; it then allocates the remaining revenues in inverse proportion to the density of each line segment to account for the fact that non-variable costs per ton are lower on high-density lines. BNSF Reply Nar. at III.A-82 to 90.

The Board has not accepted the DARA methodology in prior cases. The Board's most recent discussion of DARA, contained in the January 19, 2005 *Xcel* decision, suggests that the Board does not intend to reconsider its rejection of DARA. BNSF has appealed the Board's *Xcel* decision, including its treatment of DARA, to the United States Court of Appeals for the D.C. Circuit. However, the *Xcel* appeal may not be resolved before the Board reaches a decision in this case. Therefore, for purposes of addressing Otter Tail's SAC evidence, BNSF urges the Board to apply the modified mileage block MSP approach in this case. For the reasons described

above, that approach is a superior alternative to the use of MSP with 100-mile origination credits.⁵

D. The Board Should Reject Otter Tail's Market-Based Revenue Allocations

In the first of its many SAC presentations in this proceeding, Otter Tail based its SAC revenue calculations for cross-over traffic on extrapolations from purported real-world divisions. OTP Op. Nar. at III-A-17 to 21. Two problems with those revenue calculations render them useless. First, Otter Tail used flawed regression analyses that produced results that are grossly

⁵ The Board rejected DARA in *Xcel* on grounds that DARA "does not take into account the degree of economies of density." *Xcel III* at 10. In support of this claim, the Board presented a series of charts purporting to show that DARA allocates the same amount of revenue to on-SARR and off-SARR segments of a movement regardless of the relative economies of density of the on-SARR and off-SARR portions of the movement. There are two fundamental problems with the Board's logic.

First, economies of density are created by spreading *fixed* costs over a larger traffic group. See BNSF's Reply to Otter Tail's First Motion to Compel, May 1, 2002, Klick V.S. at 37 to 41. Therefore, to determine the relative economies of density in the three examples, the Board's charts should have looked at the average *fixed* cost per ton of each movement rather than the average total cost per ton. Average fixed costs are determined by subtracting average variable costs from average total costs. Had it made these calculations, the Board would have seen that the relative economies of density are *identical* in each of the three examples -- in each case, the SARR has exactly twice the economies of density as the residual incumbent (fixed cost per ton on the SARR is exactly half that of the residual incumbent). Under these circumstances, DARA's allocation of revenue to the SARR and the residual incumbent should not have changed in the three examples, and it does not. Contrary to the Board's claim, the examples in the *Xcel* decision show that DARA accurately reflects relative economies of density.

Second, even if the Board were correct that DARA does not precisely account for the "degree of economies of density," the Board's examples make it clear that DARA is *more* sensitive to the degree of economies of density than the MSP methodology. The premise of each example is that the SARR has greater economies of density than the incumbent and therefore should be allocated a lower amount of revenue per ton to reflect on-SARR costs. But in each example, the MSP methodology allocates exactly the *same amount* of revenue to the SARR and the residual incumbent. In other words, MSP completely ignores economies of density and therefore systematically *overstates* the revenues that are allocated to the SARR. Even if the Board was correct that DARA is not a precise methodology for reflecting economies of density, it does a better job at reflecting relative densities than the MSP methodology, and therefore it is the best evidence of an appropriate cost-based allocation of revenue between the SARR and the residual incumbent.

overreaching, particularly when applied to the OTRR's numerous short-haul movements. BNSF explained the flaws in Otter Tail's regression analyses at length in its October 8, 2003 Reply, and there is no reason to repeat that discussion here. *See* BNSF Reply Nar. at III.A-65 to 81.

The second problem is even more fundamental. As the Board correctly found in *Duke/NS*, real-world revenue divisions are irrelevant in a SAC analysis because real-world divisions "reflect a wide range of commercial considerations across a broad spectrum of traffic and gateways" that are not applicable in the stand-alone world. *Duke/NS* at 20, note 29. The Board's conclusion in *Duke/NS* that "the revenue allocation issue should reflect, to the extent practicable, the defendant carrier's relative costs of providing service over the two segments" of a cross-over movement, *Duke/NS* at 20, is the correct conclusion for economic and equitable reasons, as BNSF explained in detail in its Reply Narrative. BNSF Reply Nar. at III.A- 57 to 65.

Otter Tail complains that the Board's rejection of market-based revenue allocations in *Duke/NS* was a departure from "well-established precedent." OTP Reb. Nar. at I-48 to 49. Otter Tail's claim that there has ever been a "well-established" method for allocating revenues on cross-over traffic is incorrect. The two SAC decisions served just before Otter Tail filed its opening SAC evidence expressly stated that "we have not adopted a single, preferred procedure for developing revenue divisions on cross-over traffic." *TMPA* at 31, n. 74; *PPL I* at 7, n.14. Otter Tail also mischaracterizes *Nevada Power*. The ICC in *Nevada Power* indicated that it would consider a wide range of factors in allocating revenues on cross-over traffic, including costs. It did not adopt a standard or preferred methodology.

III. OTTER TAIL'S ABUSE OF REROUTED INTERMODAL TRAFFIC

Otter Tail's rebuttal traffic group contained 13.7 million tons of intermodal traffic that was assumed to be rerouted from BNSF's northern Minot, ND, line onto the OTRR's route through Glendive, MT. Otter Tail's prior SAC presentations had included additional rerouted

intermodal traffic -- BNSF's Z-trains -- but Otter Tail accepted on rebuttal BNSF's position that the OTRR could not expect to handle this traffic given the longer route and longer transit times.

BNSF explained in its March 22, 2004 Supplemental Reply Evidence that the 13.7 million tons of non-Z-train traffic should also be excluded because of the longer route and longer transit times for that traffic on the OTRR. In *Duke/CSX*, the Board stated that where the rerouting of traffic results in a longer haul, there is a "rebuttable presumption" that the longer route is less efficient than the real-world route. *Duke/CSX* at 16. Otter Tail did not, and could not, rebut the presumption that the addition of 101.1 miles to the real-world route of movement would produce inferior service.

Otter Tail's evidence on this point is based on its flawed string program. BNSF explained in its June 8, 2004 Motion to Strike that Otter Tail's string program evidence in this case has been a constantly moving target as Otter Tail sought to address the serious shortcomings in that model. Otter Tail's rebuttal evidence contained the *fourth* string program model it presented in this case. See BNSF Motion to Strike at 10 to 14. Complainants in SAC cases appear finally to have abandoned the string program, and Otter Tail itself eventually decided to use the RTC model in its March 2005 Supplemental Evidence. Otter Tail's string program, like the string programs used by previous complainants, produces totally unverifiable evidence that systematically understates capacity and transit time requirements. The Board cannot base any operating conclusions on the output of the string program.

However, even the string program showed that the rerouted intermodal traffic would not achieve real-world transit times. BNSF Supp. Reply Nar. at III.A-22 to 24. Otter Tail claims that the transit times on the rerouted traffic are "statistically indistinguishable" from the real-world transit times, but its statistical evidence is so inconsistent with accepted statistical methods that it does not warrant serious attention. See BNSF Motion to Strike, June 8, 2004, Mercurio

V.S. Otter Tail's additional theory that any longer transit times would be offset by more consistent service is ludicrous. *See* OTP Reb. Nar. at III-A-45 to 49. The basis for Otter Tail's claim is a comparison of BNSF's real-world transit times for *an entire year* to Otter Tail's string program results for *one week*. It is not surprising that one week of the string program results would show a smaller range of results than a year's worth of real-world data. Apart from the small number of trains in the string program, the string program used *standardized* operating assumptions. For example, each train is assumed to spend an equal amount of time in a yard. Such an approach to modeling train operations may be sufficient to determine SARR capacity (in a proper capacity model), but it cannot be used to reach conclusions about the consistency of service that would be provided by the SARR over the course of a year.

IV. OTTER TAIL'S UNDERSTATEMENT OF YARD-RELATED COSTS

The parties agree on the basic configuration of the OTRR. Moreover, in Reply to Otter Tail's Supplemental Evidence, BNSF accepted the mainline capacity of the OTRR as determined by Otter Tail's RTC model analysis. However, that RTC analysis was based on a traffic group that includes the 85 million tons of southbound PRB coal that BNSF urges the Board to exclude from the SAC analysis for the reasons described above. If the Board accepts BNSF's position that the 85 million tons of southbound coal should be excluded, the OTRR mainline capacity on the PRB segment would need to be reduced. Mainline capacity for an OTRR without the southbound PRB coal should be determined using Otter Tail's Supplemental Evidence RTC analysis but substituting BNSF's capacity assumptions for the PRB segments of the OTRR (also based on the RTC model) from BNSF's March 22, 2004 Supplemental Reply.⁶

⁶ This approach can be implemented by making limited substitutions to the following BNSF April 4, 2005 Reply to Supp. Evid. electronic workpapers: "III F track count_Reply to Supp Evidence.xls," "III F Bridge_Reply to Supp Evidence.xls," "III F 3 Curves_Reply to Supp Evidence.xls," "III F Crossings_Reply to Supp Evidence.xls," "III F OTRR Construction_Reply

The parties are close to agreement as to yard capacity,⁷ but they differ substantially in their assumptions regarding the functions that would be carried out at those yards. Accordingly, the parties have posited different assumptions on the amount of yard dwell time included in the transit times for OTRR trains (which affects equipment requirements) and the size and composition of OTRR yards (which affect construction costs). BNSF presented a detailed analysis of the yard activities needed to support OTRR trains as well as the facilities that would be needed for these functions.⁸ BNSF included the costs of the necessary facilities and the larger yards in its construction cost calculations.⁹

V. OTTER TAIL'S UNDERSTATEMENT OF OPERATING COSTS

In their rebuttal argument, Otter Tail submitted a table purporting to compare the parties' operating cost estimates per ton-mile to corresponding costs per ton-mile in recent SAC decisions. OTP Reb. Nar. at I-8. The point of this comparison was to suggest that Otter Tail's operating cost estimates were reasonable when compared to the costs determined by the Board in other cases and that BNSF's were not. However, to make these calculations, Otter Tail determined the ton-miles at issue in each case using an indirect and unreliable approach that started with the supposed "average miles per haul" on the SARR. Otter Tail provides no

to Supp Evidence.xls," tabs "Grade" and "Culvert List," and "III F 7 Facilities_Reply to Supp Evidence.xls." Specifically, the number of mainline tracks and associated facilities (turnouts, failed equipment detectors, etc.) shown between mileposts on the Orin and Reno Subdivisions in the foregoing electronic workpapers should be replaced by the numbers shown in the corresponding BNSF March 22, 2004 Supp. Reply electronic workpapers.

⁷ BNSF assumes that the OTRR would need one additional inspection/receiving track at Converse and two additional inspection/receiving tracks at Donkey Creek. BNSF Supp. Evid. Nar. at III.B-11 to 12, 15.

⁸ BNSF assumed 6 hours of dwell time in OTRR yards, which is consistent with the dwell times used in *TMPA* and *Xcel*. *TMPA* at 75. See also BNSF Reply Nar. at III.B-40 to 41, 46 to 48, 50 to 53; BNSF Supp. Reply Nar. at III.B-13 to 14; BNSF Supp. Evid. Nar. at III.B-13 to 14.

⁹ BNSF Supp. Evid. electronic workpaper "III F 7 Facilities_Supp Evidence.xls."

explanation of how this “average miles per haul” assumption was determined or how it was applied.

It is not necessary to use Otter Tail’s unsupported assumption about average length of haul. In this case, actual ton-miles can be determined directly from the workpapers.¹⁰ When actual ton-miles are used, Otter Tail’s operating costs per ton-mile are almost 20 percent lower than the costs per ton-mile set out in Otter Tail’s Rebuttal Nar. Table I-A-2.¹¹ Otter Tail’s comparative numbers for other cases are based on its flawed and unexplained “average miles per haul” methodology, so they cannot be used for any purpose.¹² But Otter Tail’s operating costs can be compared on a ton-mile basis to those in the *Xcel* decision using public data in the *Xcel* decision.¹³ That data show that the operating cost per ton-mile in *Xcel* is \$0.00676, or 65 percent higher than the operating costs that Otter Tail has presented in this case.¹⁴

¹⁰ Total net ton-miles of 46,120 million for the Supplemental Evidence traffic group in the base year can be determined by multiplying net tons by their respective SARR miles in BNSF Reply to Supp. Evid. electronic workpaper “LUMs and Carmiles (OTP-BNSF) (Supp Evidence Reply).xls.”

¹¹ Otter Tail’s Supplemental Evidence operating expenses per ton-mile are \$0.0041. This is calculated by dividing operating expenses of \$189.17 million by net ton-miles of 46,120 million. OTP Reply to Supp. Evid. electronic workpaper “EXHIBIT-III-H-4-SP.123,” sheet “Summary.” Otter Tail’s Rebuttal Nar. Table I-A-2 shows operating expenses per ton-mile of \$0.0050.

¹² The other figures are also in nominal dollars that have not been indexed.

¹³ The Board’s December 14, 2004 technical corrections decision identified total LUMS (10,556,011). *Xcel II* at 3. Since each train in the *Xcel* traffic group has three locomotives per train, there are 3,518,670 total train miles, or 1,759,335 loaded train miles. If one assumes that each train has 120 cars and each car has 115 tons lading weight, the total lading per train is 13,800 tons. Multiplying this amount by the total train miles produces 24,279,000,000 net-ton-miles. Total base year operating costs are \$164,240,000. The Board, of course, does not have to rely on these figures because it can identify the actual ton-miles from its workpapers in the *Xcel* case.

¹⁴ BNSF’s operating costs per ton-mile in this case are somewhat higher than the \$0.00676 in *Xcel*, but that difference is attributable to the inclusion of non-coal traffic in this case. In a SAC analysis, non-coal train operating costs per ton-mile are higher than operating costs per ton-mile of coal trains because the costs of locomotives, crew and fuel on non-coal

The specific operating unit cost assumptions and costing methodologies used by BNSF in this case are consistent with the units costs and methodologies used by the Board in prior SAC decisions. As to locomotive ownership, the lease rate used by BNSF for the OTRR's SD70 locomotives is virtually identical to the lease rate used in *Xcel*.¹⁵ Otter Tail's lease rate is 30% lower. The problem with Otter Tail's lease rate assumption is simple: The relevant leases are structured so that most of the payments, including some large balloon payments, are made late in the leases. Otter Tail cherry picked the payments made in an early year in the lease and ignored the higher payments occurring later in the lease. BNSF Reply Nar. at III.D-1 to 3.

The number of locomotive units is also in dispute, but the calculation of locomotive units was discussed at length in BNSF's Supplemental Evidence and Reply to Otter Tail's Supplemental Evidence.¹⁶ That evidence does not need to be addressed further except to note that Otter Tail's Reply to BNSF's Supplemental Evidence identified three minor errors in BNSF's calculation of cycle times used to determine OTRR equipment requirements. OTP Reply to Supp. Evid. Nar. at III-C-12 to 15. Those errors can be easily corrected.¹⁷

trains are similar to those costs on coal trains but they are spread over fewer tons on non-coal trains.

¹⁵ The lease rate for the OTRR's SD70 locomotives is { }. See BNSF Reply Nar. at III.D-2. The lease rate for SD70 locomotives approved by the Board in *Xcel* was \$132,795. See *Xcel I* at 60.

¹⁶ Otter Tail's understatement of locomotive units affects locomotive ownership costs. It also affects locomotive maintenance costs not only because the number of units is understated but also because the extremely high utilization rate that results from the understatement of units allows Otter Tail to assume highly favorable maintenance rates for the OTRR SD70 locomotive fleet. BNSF Reply Nar. at III.D-4 to 5.

¹⁷ To correct the cycle time errors, place a "0" in cells BV14, BV15, BV22, BV23, BV57, BV58, BV59, BV71, BV72, CH236, CI236, CJ236, CK236 and CH237, and a "1" in cell CK23 in BNSF Supp. Evid. electronic workpaper "LUMs and Carmiles (OTP-BNSF) (Supp Evidence Reply).xls" sheet "Coal Crew Districts". The Board will also notice that BNSF erroneously included only 3 hours of dwell time for OTRR trains at Converse rather than the 6 hours that should be included. To correct the Converse dwell time, place a "6" in cell CG233. The

BNSF's crew salary assumptions are also virtually identical to those accepted by the Board in *Xcel*.¹⁸ The Board in *Xcel* criticized BNSF's use of peak period operating statistics to determine crew requirements, and BNSF therefore based its crew count in the Reply to Otter Tail's Supplemental Evidence on the actual number of crew starts throughout the year, thus eliminating the Board's concern. BNSF Reply to Supp. Evid. Nar. at III.D-12.

On fuel consumption, Otter Tail failed to include fuel consumed in switching operations in calculating an URCS-based fuel consumption rate for OTRR trains. BNSF Reply Nar. at III.D-17 to 18. On rebuttal, Otter Tail correctly pointed out that BNSF made a slight error in calculating switching fuel consumption. Otter Tail Reb. Nar. at III-D-17. That error can be corrected without ignoring altogether switching fuel consumption, as Otter Tail proposes.¹⁹

BNSF's MOW costs are also consistent with MOW costs determined by the Board in prior SAC decisions. On a route-mile basis, BNSF's MOW costs in this case fall between the MOW costs in *Xcel* and those in *TMPA*.²⁰ BNSF demonstrated that its MOW staffing assumptions, a significant component of overall MOW operating costs, are comparable to those of major shortline railroads, the MRL and the FEC. BNSF Reply Nar. at III.D-174 to 175. At the same time, Otter Tail's MOW plan is virtually indistinguishable from the MOW plans that have been submitted by complainants in recent cases and rejected by the Board. The Board has

supposed error identified at pages III.C-10 to 12 of Otter Tail's Reply to Supp. Evid. Nar. is no longer relevant since BNSF has accepted Otter Tail's mainline transit times.

¹⁸ Compare the crew salary that appears on page 68 of the Board's *Xcel I* decision to the crew salary in BNSF's Reply to Supp. Evid. electronic workpaper "OPR_EXP_supEvid-Reply.xls."

¹⁹ The error can be corrected by adding the switching LUMS (lines 12 and 13 of Schedule 755) to the denominator of BNSF's fuel consumption calculation, set out at BNSF Supp. Evid. electronic workpaper "Otter Tail Fuel Corrected_supplemental.xls" cell C10.

²⁰ BNSF's MOW operating costs are \$56,820 per route mile compared to \$66,998 per route mile in *Xcel* and \$51,124 per route mile in *TMPA*.

properly rejected MOW plans like Otter Tail's that are based on unspecified work done by unidentified outside contractors for fees that are unrelated to the work supposed to be performed.²¹

Otter Tail claims that its MOW operating plan is based on experience with WRPI, but its vague claims regarding WRPI are implausible, totally unsupported by any competent evidence and totally unverifiable. For example, Otter Tail claims that WRPI experienced "only three (3) service failures in six (6) years between 1985 and 1991, or an average of only 1 every 2 years." Otter Tail Reb. Nar. at III-D-105, n.98. Otter Tail offers no supporting data for this astonishing claim. Similarly, Otter Tail asserts, with no support, that "WRPI, with considerably higher tonnages than OTRR, averaged one person for every 5.8 route miles." OTP Reb. Nar. at III-D-122. It is impossible to know whether this claim is accurate, what time frame the claim involves, what personnel are included in the number, or what line segment is at issue. Unverifiable evidence such as this is incompetent and cannot be relied upon.

VI. OTTER TAIL'S UNDERSTATEMENT OF CONSTRUCTION COSTS

Otter Tail also asks the Board to compare the parties' construction cost estimates in this case to the Board's construction cost estimates in recent SAC decisions. Otter Tail's request is odd, since its own cost estimate for the OTRR is clearly out of line with the Board's most recent SAC decisions -- Otter Tail's costs would have to be increased by more than *20 percent* to be comparable to the Board's most recent cost estimate in the *Xcel* case.²² Moreover, there are several aspects of the OTRR construction that would produce *higher* costs per track mile than the costs determined in recent SAC cases. For example, substantial additional costs are needed to

²¹ *Xcel I* at 79; *Duke/CSX* at 67; *Duke/NS* at 82; *CP&L* at 69.

²² Otter Tail's construction costs are about \$1.48 million per track-mile compared to about \$1.81 million per track-mile in *Xcel*. See *Xcel II* at 8 (construction cost of \$1,227.7 million) and *Xcel I* at 48 (track miles of 679.07).

meet the OTRR's aggressive construction schedule in a part of the country where the average temperature is below freezing for seven months of the year. *See* BNSF Reply Nar. at III.F-101-105. Indeed, as BNSF pointed out, nearly one-third of the OTRR construction activity is assumed to take place from November through January, when the average temperature is only six degrees above zero and daylight hours are limited. *Id.*

BNSF does not believe that it is particularly meaningful to compare the parties' cost estimates to costs determined in past cases since each SARR is different and each case is supposed to be based on the specific evidence in the record. A multitude of complex construction cost issues in dispute in this case must be decided based on the evidence submitted by the parties. That evidence must be evaluated in light of the complainant's burden of proof and the requirement that the complainant demonstrate, based on verifiable data, that its estimates are feasible. The limited space in this final brief does not provide an opportunity to address all issues that are in dispute. A few of the more significant issues are summarized below.

Earthworks: Otter Tail understated mainline excavation quantities by assuming a narrower roadbed between Reno Junction and Donkey Creek than the existing roadbed. BNSF Reply Nar. at III.F-55. While it might be theoretically possible to operate unit coal trains over high density tracks with a narrow 24 foot roadbed, Otter Tail submitted no evidence whatsoever that the OTRR could provide the same level of service using a 24 foot roadbed that BNSF provides using a wider, 28 foot roadbed. Similarly, Otter Tail assumes that access roads can be ignored. But as BNSF explained, the current level of operations in the PRB are possible only because an extensive network of access roads allows vendors, contractors and maintenance crews to access various facilities without disrupting train service. *Id.* at III.F-56. Otter Tail cannot reasonably expect to meet existing service levels without the facilities that make efficient service possible.

Otter Tail also understated the earthwork quantities on branch lines. Otter Tail used the CARDS program to estimate these earthworks quantities. That program relies on user supplied inputs for railroad subgrade elevation, among other things, to estimate earthwork quantities. The subgrades used by Otter Tail, however, do not conform to the actual subgrades identified in data produced by BNSF in discovery. BNSF Reply Nar. at III.F-69. Otter Tail claims that it is entitled to assume idealized subgrades since it is a “least-cost” railroad. Otter Tail Reb. Nar. at III-F-47 to 48. But the SAC test does not allow the complainant to ignore the physical characteristics of the land on which the SARR lines are to be built.

A significant difference in earthworks cost is attributable to different equipment that the parties assume would be required to prepare the roadbed. This is a complex issue where the defendants are at a procedural disadvantage because they do not have the opportunity to respond to a complainant’s rebuttal. Here, BNSF was the only party that provided evidence from the real world on the soil composition and equipment needed on the OTRR route. BNSF Reply Nar. at III.F-48 to 52 and 81 to 100; electronic workpaper “BNSF III F Field Trip,” file “Earthwork Equipment.” Otter Tail criticized the adequacy of this evidence, arguing, for example, that BNSF should have provided core samples to support its evidence. OTP Reb. Nar. at III-F-58 to 59. BNSF has not had an opportunity to address Otter Tail’s many claims on rebuttal. Nevertheless, BNSF’s evidence on equipment requirements is the only real-world evidence in this case and it is the best evidence in the record.

Track Construction: A major difference between the parties on track construction involves the unit costs for subballast. Otter Tail based its entire subballast cost estimate on a unit cost derived from a BNSF AFE that is clearly aberrant. BNSF showed that twelve other AFEs contained subballast costs, and the one AFE cherry picked by Otter Tail was one-third less than the next lowest cost and one-fifth of the highest cost. BNSF Reply Nar. at III.F-138 through

139. Use of such an unrepresentative AFE does not produce a reliable cost estimate. BNSF's unit cost -- the average of the AFE costs after excluding the highest and lowest costs -- is a far better reflection of real-world costs.

Bridges: Otter Tail excluded the costs of 34 bridges over highways that were identified in the railroad inventory contained in the ICC Engineering Reports. BNSF Reply Nar. at III.F-174 through 175. The Board's practice has consistently been to treat the ICC Reports as identifying investments incurred by the railroad. Otter Tail offers nothing but speculation to rebut this longstanding presumption as it relates to the 34 bridges. In addition, BNSF's approach to estimating the cost to construct individual bridges is far more accurate than Otter Tail's approach. Otter Tail relied on broad averages while BNSF focused more precisely on the characteristics of the individual bridges that the OTRR would need to construct. BNSF Reply Nar. at III.F-178 through 186.

VII. THE BOARD SHOULD REJECT THE DCF CHANGES THAT OTTER TAIL BELATEDLY ASKS THE BOARD TO MAKE

On rebuttal, Otter Tail presented two major changes to the DCF methodology it used to prepare its opening evidence. First, it presented a new inflation index supposedly based on productivity assumptions in the EIA's transportation rate forecast. OTP Reb. Nar. at III-G-11 to 13. As BNSF explained in its June 8, 2004 Motion to Strike, such evidence should be struck from the record since it exceeds the scope of permissible rebuttal evidence. In any event, the Board rejected in *Xcel* the use of the same EIA-based productivity factor on grounds that it "suffers the same flaws as RCAF-A: both predict the productivity improvements the railroad industry as a whole is expected to experience in the future." *Xcel I* at 34. As in the *Xcel* case, projections of the RCAF-U provide the best evidence in this case of operating cost inflation that would be experienced by a new entrant into the market that uses new, state-of-the-art technology from the beginning of its operations.

Second, Otter Tail introduced on rebuttal a major change in the way it calculated the OTRR's cost of capital. BNSF had accepted on reply the cost of capital methodology proposed by Otter Tail on opening, so Otter Tail was not free to offer a new approach. *See Duke/NS* at 14, note 18. Moreover, Otter Tail's opening methodology followed the approach that has been used consistently in SAC cases, which is to base the SARR's cost of debt on the industry average cost of debt over the period in which the SARR is constructed. On rebuttal, however, Otter Tail assumed that the OTRR would "refinance the debt portion of its capital structure in 1Q03" at an interest rate of 4.99 percent. OTP Reb. Nar. at III-G-2.

In response to BNSF's June 8, 2004 motion to strike this evidence, Otter Tail disingenuously claims that it "merely updated its cost of debt consistent with Board precedent." Complainant's Reply to Defendant's Motion to Strike, July 20, 2004, at 18. Otter Tail's rebuttal evidence does not represent an updating of its prior assumptions but a complete change in the methodology it used without any justification or supporting evidence. Otter Tail submitted no evidence that a refinancing of the OTRR's debt burden was feasible, and it submitted no evidence of the interest rates or financing fees that might be applicable if a refinancing were feasible.

Finally, Otter Tail appears to agree that the DCF analysis should be carried out based on a revenue stream that does not include the fuel surcharge that BNSF began applying to its common carrier movements in 2004. *See BNSF Supp. Evid. Nar.* at III.A-14. However, Otter Tail also argues that BNSF should be denied *any* revenues from the fuel surcharge if a rate is prescribed because the use of the RCAF-U in the SAC analysis adequately compensates BNSF for the recent increases in the price of fuel. OTP Reply to Supp. Evid. Nar. at III-A-9. BNSF disagrees, but it is not possible to address this fact-intensive issue in a final brief. As BNSF explained in its Supplemental Evidence, the proper treatment of a fuel surcharge has never been

addressed by the Board and it was not the subject of evidentiary filings in this case. If the Board concludes that a rate must be prescribed, the parties can address the effect of the fuel surcharge on the level of any prescribed rate in subsequent pleadings.

VIII. THE *PPL* CROSS-SUBSIDY TEST SHOULD BE USED TO ENSURE THAT ANY RATE PRESCRIPTION RESULTING FROM THE SAC ANALYSIS IS NOT BASED ON AN IMPERMISSIBLE CROSS-SUBSIDY

The parties agree that the *PPL* test should be used to determine whether a complainant has impermissibly relied upon a cross-subsidy in its SAC evidence, although Otter Tail disagrees with the Board's treatment of operating costs in the *PPL* test. Specifically, Otter Tail claims that the Board should consider only the "variable" portion of the operating expenses of the east-west traffic. OTP Reply to Supp. Evid. Nar. at III-A-12 to 14. As the Board found in *PPL*, Otter Tail's argument confuses the two distinct methodologies for calculating the attributable operating costs of the east-west traffic. *PPL III*, at 8.²³ The Board's "bottom-up" approach is the most accurate way to determine direct operating costs, and when that approach is used, there is no reason to distinguish between supposed "fixed" and "variable" portions of the operating costs.

The Board applies the *PPL* test after it resolves disputed cost and revenue issues. As BNSF explained in its April 4, 2005 Reply to Supplemental Evidence, even modest changes in Otter Tail's cost assumptions will produce the same result that the Board reached in *PPL*, namely that the complaint should be dismissed because the extensive and relatively low-density, east-

²³ The first methodology, which both parties used to identify direct operating expenses (e.g., locomotive and crew costs), is an accurate bottom-up methodology that identifies the total operating costs that would be avoided by the OTRR if it did not handle the east-west traffic. The second methodology, which the parties did *not* use to identify direct operating expenses, would start with total operating expenses for the system and then allocate those expenses on a ton-mile or train-mile basis to the two portions of the OTRR. Under this latter approach, a question is raised whether an additional adjustment should be made to the allocated amounts to distinguish between the variable and fixed components of the allocated costs. BNSF does not believe such an adjustment would be warranted, *see* BNSF Supp. Evid. Nar. at III.A-32 to 33, but the question does not even arise if the operating costs are identified through the first, bottom-up approach.

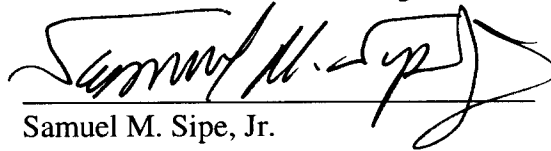
west lines used by the issue traffic do not generate revenues sufficient to cover the attributable costs of the east-west traffic. BNSF Reply to Supp. Evid. Nar. at III.A-6 to 10. However, if the Board were to find that east-west revenues exceed the directly attributable costs of the east-west traffic, the maximum rate reduction for purposes of setting a prescribed rate would be an amount that eliminates the supposed overcharge on the east-west traffic. As BNSF demonstrated in its Reply to Supplemental Evidence, that rate reduction would be far less than the rate reduction sought by Otter Tail in this case, even if all of Otter Tail's cost and revenue assumptions were accepted. *Id.* at III.A-9 to 10.

BNSF demonstrated with a simple hypothetical that any rate reduction exceeding the amount of the supposed overcharge on the east-west traffic would violate the prohibition on cross-subsidy because it would produce a SARR whose east-west lines do not generate revenues that cover their costs. BNSF Supp. Evid. Nar. at 35 to 39 and accompanying exhibits. Therefore, as BNSF explained, the *PPL* test can be used at the rate prescription phase to ensure "that any rate prescription resulting from the SAC analysis would not reflect an impermissible cross-subsidy." December 13, 2004 Decision at 3. Contrary to Otter Tail's claim in its Reply to Supplemental Evidence, the *PPL* test applies with equal validity at the rate reasonableness and rate reduction phases of the SAC analysis. The Board in *PPL* acknowledged that the Board's rate reduction methodology should not be used to exacerbate a subsidy. *PPL II* at 4, note 14. Nor should it be used to create a subsidy. The rate reduction methodology should not be used to produce a result that would never exist in a contestable market -- *i.e.*, a SARR in which the traffic moving over the issue traffic route does not contribute revenue sufficient to cover its collective attributable costs.

IX. CONCLUSION

Otter Tail's SAC evidence is based on fundamental conceptual flaws as well as unsupported and erroneous cost assumptions. When the SAC test is implemented using appropriate cost and revenue assumptions, it is clear that the challenged rate does not exceed a reasonable maximum rate. The Board should dismiss Otter Tail's complaint.

Respectfully submitted,



Richard E. Weicher
Michael E. Roper
David M. Pryor
BNSF Railway Company
2500 Lou Menk Drive
Fort Worth, TX 76131
(817)352-2353

Samuel M. Sipe, Jr.
Anthony J. LaRocca
Linda S. Stein
STEPTOE & JOHNSON, LLP
1330 Connecticut Avenue, N.W.
Washington, DC 20036
(202)429-6486

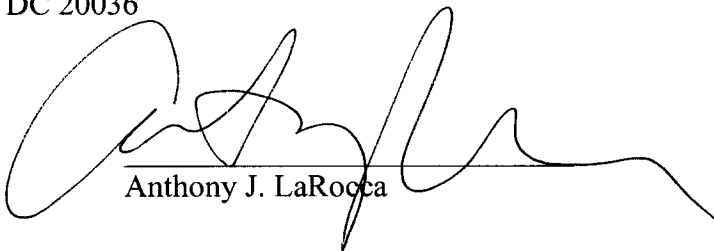
Attorneys for BNSF Railway Company

Dated: April 27, 2005

CERTIFICATE OF SERVICE

I hereby certify that on April 27, 2005, a true and correct copy of the Final Brief of BNSF
was served by hand on:

Nicholas J. DiMichael
Jeffrey O. Moreno
Michael H. Higgins
Thompson Hine LLP
1920 N Street, N.W.
Suite 800
Washington, DC 20036



Anthony J. LaRocca