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PUBLIC VERSION
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EXPEDITED CONSIDERATION REQUESTED

BEFORE THE
SURFACE TRANSPORTATION BOARD

RECEIVED
MANAGEMENT
STB

DOCKET NO. 42077

ARIZONA PUBLIC SERVICE COMPANY AND PACIFICORP

v.

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY

Office of General Counsel
STB
June 16, 2003

PETITION FOR INJUNCTIVE RELIEF

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Pursuant to 49 C.F.R. § 1117.1, Peabody Energy Corporation (“Peabody”) seeks an order under both 49 U.S.C. § 721(b)(4) and the “Phasing Constraint” in Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 547-48 (1985), to enjoin The Burlington Northern and Santa Fe Railway Company (“BNSF”) from collecting the rates established in BNSF Common Carrier Pricing Authority 90040-A, Supplement No. 4 (“BNSF 90040-A”). Specifically, Peabody requests that the Board immediately (1) enter an order instructing BNSF not to collect a rate higher than the last effective contract rate from the Lee Ranch Mine to the Cholla Electric Generating Station (“Cholla” or “Cholla Station”) during the pendency of this proceeding; and (2) order BNSF and APS to keep account of the amounts paid during the pendency of this proceeding and to make the other party whole, at the conclusion of this proceeding, with respect

to the amounts paid during the interim, based on what the Board ultimately finds to be the maximum reasonable rate.

Contemporaneous with this Petition, Peabody also has filed a “Petition to Intervene” and a “Motion for Expedited Relief.” All three pleadings are supported by the Verified Statement of Colin Kelly (“Kelly V.S.”), which is attached as Exhibit 1 hereto. In addition, this Petition is supported by the Verified Statement of Thomas O’Connor (“O’Connor V.S.”), which is attached hereto as Exhibit 2.

I. BACKGROUND AND STATEMENT OF INTEREST

A. Identity of Peabody Coal Corporation.

Peabody is a private sector coal company with majority interests in 33 coal operations located throughout all major United States coal producing regions. (Kelly V.S. at 1) It conducts operations in the Powder River Basin, Southwest, Appalachia and Midwest regions. (Id.) Through the Lee Ranch Coal Company, a wholly-owned subsidiary, Peabody owns and operates the Lee Ranch Mine (“Mine”), located near the town of Grants in northwestern New Mexico. (Id. at 1-2) In 2002, the Mine shipped 6.3 million tons of coal recovered from 26 seams that lace a 170 million ton reserve in the San Juan Basin. (Id. at 2) The Mine employs 300 workers and annually injects more than \$34 million into the New Mexico economy in royalties, taxes, wages and charitable contributions. (Id.)

B. Statement of Interest and Relevant Facts.

This Petition is necessitated by the gross and artificial disparity in rail rates to the Cholla Station, located near Joseph City, Arizona, from the McKinley and Lee Ranch Mines, located in New Mexico. Arizona Public Service Company and PacifiCorp (collectively, “APS”) own the Cholla Station. The Pittsburgh and Midway Coal Mining Company owns the McKinley Mine.

This disparity exists because of two pending rate complaints filed by APS against BNSF, challenging the reasonableness of BNSF's rates from each mine to the Cholla Station, and the different effect currently given to BNSF's rate while each case is pending.

In the first Complaint, in Docket No. 41185, Arizona Public Service Co. and PacifiCorp v. The Atchison, Topeka and Santa Fe Ry. Co. (the "McKinley Case"), APS challenged the reasonableness of BNSF's rate from the McKinley Mine to Cholla. APS initiated that proceeding by complaint filed on January 3, 1994. In a decision served on July 29, 1997, the STB concluded that BNSF's rates were unreasonably high and prescribed maximum reasonable rates through 2013. However, on January 13, 2003, BNSF petitioned to reopen the case and vacate the rate prescription due to changed circumstances. BNSF sought to increase the prescribed rate of \$4.21 per ton to \$6.91, retroactive to January 1, 2003. APS agreed that it was appropriate to reopen the case, but disagreed as to the scope of the reopening and objected to lifting the rate prescription.

In this proceeding, Docket No 42077, Arizona Public Service Co. and PacifiCorp v. The Burlington Northern and Santa Fe Ry. Co. (the "Lee Ranch Case"), APS has challenged the reasonableness of BNSF's rates for the transportation of coal from the Lee Ranch Mine to Cholla, published in BNSF 90040-A. At the same time BNSF was attempting to reopen the McKinley Case to increase its rates from the McKinley Mine to Cholla, BNSF did raise its rates from the Lee Ranch Mine to Cholla. For four years prior to January 1, 2003, BNSF delivered coal from the Lee Ranch Mine to Cholla pursuant to a rail transportation contract designated BNSF-C-12203, which expired on December 31, 2002. (Complaint, ¶8) When APS and BNSF were unable to agree upon a new contract, BNSF issued BNSF-90040-A to apply to the transportation of coal from Lee Ranch to Cholla, beginning January 1, 2003.

BNSF 90040-A immediately increased the rail rates for the transportation of coal from the Lee Ranch Mine to Cholla from the previously effective contract rate of approximately [REDACTED]¹ per ton² to \$8.62, an increase of nearly [REDACTED]%. (Kelly V.S. at 4-5) In addition, the new tariff rate is subject to a 2.0-2.5% fuel surcharge [REDACTED] [REDACTED] which adds 17-21¢ per ton to the tariff rate. (Id. at 5) Furthermore, BNSF has indicated that it may impose a \$600 per hour demurrage charge for unloading time in excess of 24 hours, [REDACTED] (Id.) This adds approximately \$2.00 per ton to the rail rate. (Id.) [REDACTED] [REDACTED] (Id.) The cumulative effect of these charges is an immediate increase in the rail rate from \$[REDACTED] per ton to \$10.83, or an increase of nearly [REDACTED]%. (Id.) APS initiated this proceeding by Complaint filed on January 30, 2003 to challenge these rate increases.

APS also asked the Board to consolidate both the McKinley Case and the Lee Ranch Case into a single proceeding, since both proceedings involved rates for transportation of coal from mines in New Mexico to Cholla and because APS anticipated presenting stand-alone cost evidence in both cases using a single stand-alone railroad.

In a decision served in both dockets on May 12, 2003 ("May 12 Decision"), the Board reopened the McKinley Case, but adopted a narrower scope of reopening than APS had requested. Because of this narrower scope, the Board denied APS's motion to consolidate the

¹ The shaded text is highly confidential and confidential material that has been redacted from the public version of this filing.

² Because BNSF-C-12203 was a confidential contract, Peabody does not know the precise rate. However, based on publicly available delivered cost information and the coal supply agreement between APS and Peabody, Peabody witness Colin Kelly has estimated the last effective contract rate to be approximately [REDACTED] per ton. (Kelly V.S. at 4) Therefore, throughout the rest of this Petition, \$[REDACTED] is referred to as "the last effective contract rate." Peabody's request for relief, however, is pegged to the actual last effective contract rate, at whatever level it may be. Contemporaneous with this Petition, Peabody has served discovery on APS and BNSF requesting a copy of the contract. Upon obtaining this discovery, Peabody will amend this Petition with the actual last effective contract rate.

McKinley and Lee Ranch cases. In reopening the McKinley Case, the Board also lifted its rate prescription for the McKinley to Cholla movement, which would have allowed BNSF to increase its rate immediately. However, because the Board was “concerned that allowing BNSF to charge its proposed \$6.91 per ton rate, even if only temporarily, could needlessly expose Arizona to significant financial hardship,” it used its broad authority under 49 U.S.C. § 721(b)(4) to instruct BNSF to collect no more than the previously prescribed rate of \$4.21 per ton until the conclusion of the reopened proceeding. May 12 Decision, slip op. at 7. During that time, the Board instructed the parties to keep account of the amounts paid in order to make the other party whole based upon the final determination of a maximum reasonable rate. Id. On June 3, 2003, APS and Western Coal Traffic League filed Petitions for Reconsideration of the May 12 Decision.

Four coal-fired units comprise the Cholla Station with a total net output of approximately 1000 MW.³ (Complaint, ¶4) All four units cumulatively consume a total of approximately 3.5 to 4 million tons of coal annually. (Id.) Due to the vintage and permit constraints of each unit, Cholla receives coal from four different sources. (Kelly V.S. at 3) The McKinley and Lee Ranch Mines supply the vast majority of the coal burned at Cholla. (Id.) Cholla burns lesser amounts of coal from the Spring Creek Mine in Montana [REDACTED], and from the Colowyo Mine in Colorado [REDACTED]. (Id. at 3-4)

In 2002, the Lee Ranch Mine supplied 627,000 tons of coal to Cholla, or approximately 15-18% of Cholla’s total coal consumption. (Id. at 4) Beginning in 2004, Peabody had projected gradually increasing coal sales from the Mine to Cholla up to [REDACTED] by 2008. (Id.) However, because APS must pay the increased rate from the Lee Ranch Mine immediately while still paying the lower rate from the McKinley Mine, the Lee Ranch to Cholla rail rate

³ Units 1, 2 and 3 are owned and operated by APS, while Unit 4 is owned by PacifiCorp and operated by APS. Id.

currently is [REDACTED]% greater than the McKinley to Cholla rail rate, contrasted to only a [REDACTED]% difference prior to January 1, 2003.⁴ (Id. at 7) This gross disparity will give the McKinley Mine a substantial and potentially decisive competitive advantage over the Lee Ranch Mine for the sale of coal to Cholla. [REDACTED]

[REDACTED]. (Id. at 8)

As a major supplier of coal to the Cholla Station, Peabody is extremely concerned that the gross disparity in rail rates to Cholla from the Lee Ranch and McKinley Mines will inflict severe economic dislocations upon the market for San Juan Basin coal, and particularly the sale of coal to the Cholla Station. This gross disparity has occurred because the STB has enjoined BNSF from raising the McKinley Mine rail rate, while BNSF is allowed to increase the Lee Ranch rail rate immediately, subject only to the ability of APS to obtain reparations. Although reparations may protect APS, they do not protect Peabody. Therefore, despite the temporary duration (2-3 years while the Lee Ranch Case is pending) of the economic consequences, the harm to Peabody will be immediate, substantial, and irreparable.

II. THE “PHASING CONSTRAINT” PROTECTS AGAINST IRREPARABLE HARM FROM THE SIGNIFICANT ECONOMIC DISLOCATIONS OF RAIL RATE INCREASES.

In Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d at 546-47, the ICC provided for the relief that Peabody requests in this Petition. In addition to the Stand Alone Cost, Management Efficiency, and Revenue Adequacy constraints for determining a maximum reasonable rate, the ICC also adopted a “phasing constraint” in order “to further constrain a carrier’s pricing of captive coal traffic by generally limiting otherwise permissible rate increases” that could cause

⁴ The rate differential still is a substantial [REDACTED] when the fuel surcharge and demurrage charges are excluded from the Lee Ranch rate. (Kelly V.S. at 7, note 4)

significant economic dislocations. Id. at 546. The ICC concluded that, in those situations, “phasing may be an appropriate means of balancing the public need for a sound, healthy rail system with the public need for smooth, orderly economic transitions.” Id.

Peabody strongly believes that, given the specific facts of this case, a phasing constraint in the form of temporary injunctive relief during the pendency of this proceeding, is appropriate regardless of whether BNSF ultimately justifies the rate levels in BNSF 90040-A or whether APS ultimately justifies a rate lower than the rate that BNSF is seeking. Although the discussion of a “phasing constraint” in Coal Rate Guidelines, Nationwide is in the context of relief from an “otherwise justified” rate increase, which implies application upon a final agency decision, a “phasing constraint” must be available immediately upon the filing of a rate Complaint if it is to be of any value. Otherwise, the rate already will have been in effect for some period of time while the case is pending.⁵ In that case, the economic dislocations will have wreaked their havoc and caused irreparable harm before the phasing constraint can ever be implemented in a final decision. Clearly, the agency could not have intended this anomalous result. Moreover, to the extent the Board has any doubts about its authority to grant interim relief under the phasing constraint, the purpose and objectives of the phasing constraint provide a basis for invoking the Board’s injunction authority under 49 U.S.C. § 721(b)(4) to grant the same relief.

The party requesting a phasing constraint must demonstrate the need for it with specificity. Id. at 547. In balancing the equities, the Board will consider such factors as

the short-term revenue requirements of the railroads, the magnitude of the proposed increase, the magnitude of past increases, the impact of the rate increae [sic] on kilowat-hour [sic] charges, the dependence of the utility on coal (as opposed to other fuels), the economic conditions in the final destination market (and the impact of the rate change on that market), the economic

⁵ In this case, it is highly likely that the determination of a maximum reasonable rate from the Lee Ranch Mine to Cholla under the SAC constraint might take at least two to three years.

conditions in the coal supply area (and the impact of the rate increase on that region), and supply contracts involved.

Id.

From this discussion of the phasing constraint in Coal Rate Guidelines, Nationwide, it is clear that Peabody must make two showings to be entitled to relief. First, Peabody must demonstrate that the transportation of coal from Lee Ranch Mine to Cholla is captive to BNSF. Second, Peabody must demonstrate the need for a phasing constraint. Peabody makes each of these showings below.

A. The Movement of Coal from Lee Ranch to Cholla is Captive to BNSF.

Although the discussion of phasing constraints does not define the term “captive,” Peabody has taken a conservative approach and presumed it must demonstrate BNSF’s market dominance over the transportation of coal from the Lee Ranch Mine to the Cholla Station. As demonstrated in the following sections, BNSF possesses both quantitative and qualitative market dominance over this movement.

1. The rates in BNSF 90040-A generate a revenue to variable cost ratio in excess of 180%.

BNSF possesses quantitative market dominance over the transportation of coal from the Lee Ranch Mine to the Cholla Station, pursuant to 49 U.S.C. § 10707(d), because the revenues produced by this traffic at the rates in BNSF 90040-A exceed 180% of BNSF’s variable cost of providing this service. Peabody Witness O’Connor has calculated BNSF’s revenue-variable cost percentage in his attached verified statement. His analysis is a conservative overstatement of BNSF’s variable costs, because he has relied upon URCS system average costs, which do not reflect the economies and efficiencies of unit-train coal transportation. (O’Connor V.S. at 7-9)

Even so, Mr. O'Connor determined that BNSF's revenue-variable cost percentage for this movement is over 300%, or well above the 180% jurisdictional threshold. (Id. at 8)

2. There is no effective intra or intermodal competition.

There can be little doubt that the movement of coal from the Lee Ranch Mine to the Cholla Station is captive to BNSF. There clearly is no existing or potential intramodal competition since there is not another railroad within 250 miles of either the Lee Ranch Mine or the Cholla Station. (Kelly V.S. at 5) Intermodal competition also is non-existent. There is no navigable waterway near either the Lee Ranch Mine or Cholla. (Id.) Furthermore, the Board already has concluded that there is not truck competition from McKinley to Cholla, which is much closer to Cholla than the Lee Ranch Mine. Docket No. 41185, Arizona Public Service Co. and PacifiCorp v. The Atchison, Topeka and Santa Fe Ry. Co., slip op. at 6-7 (served July 29, 1997) ("July 29 Decision"). Truck movements from Lee Ranch would have to traverse the same route as trucks from McKinley, and therefore would encounter all of the same obstacles that the Board observed in the July 29 Decision. (Kelly V.S. at 6)

B. Peabody Has a Specific Need for a Phasing Constraint.

The dramatic, sudden and unexpected increase in BNSF's rail rates from the Lee Ranch Mine to the Cholla Station will result in severe economic dislocations and consequent irreparable harm to Peabody that outweigh the equities that ordinarily allow the carrier's rate to control pending resolution of a rate complaint proceeding. This is demonstrated by an examination of the factors enumerated by the ICC in Coal Rate Guidelines, Nationwide, for consideration in applying a phasing constraint.

The magnitude of the proposed rate increase is enormous. The transportation rate itself has been increased by ■%. (Kelly V.S. at 5) The increase jumps to ■% when fuel surcharges

are added, and to [REDACTED] when [REDACTED] demurrage charges are assessed. (*Id.*) This is comparable to, and even greater than, the 64% increase in BNSF's rate from the McKinley Mine to Cholla that prompted the Board to enjoin BNSF from collecting that rate. May 12 Decision, slip op. at 7.

The [REDACTED]% increase in just the base rail rate from Lee Ranch to Cholla is substantially greater than rail rate increases to other western utilities that also have rate cases pending before, or recently decided by, the STB. Peabody Witness O'Connor has estimated the percentage increase in rail rates to the following three other electric generating stations served by BNSF: Texas Municipal Power Agency's Gibbons Creek Station; Otter Tail Power Company's Big Stone Station; and Xcel Energy's Pawnee Station. The first two stations are captive to BNSF. In each of these instances, the utility filed a rate complaint with the STB after the railroad published tariff rates that were substantially higher than previously effective contract rates. Mr. O'Connor has estimated the contract rates from publicly available data and calculated the percentage increase of the tariff rate. (O'Connor V.S. at 19-28) The rate increases were 4.3% for Gibbons Creek; 15.9% for Big Stone; and 17.00% for Pawnee. (*Id.* at 26, 27-28) All three rate increases are substantially less than the [REDACTED]% increase imposed upon the Lee Ranch to Cholla movement, even allowing substantial room for error in Mr. O'Connor's estimates.

In Coal Rate Guidelines, Nationwide at 546, the STB proposed to limit permissible rate increases to 15% annually, but ultimately decided not to adopt a bright-line standard. Instead, the Board concluded that "the degree of phasing should be tailored to the equities of the situation at hand." Clearly, a [REDACTED]% rate increase, which is more than [REDACTED] 15% threshold originally proposed by the Board, and which also is more than [REDACTED] the increase in other

challenged rail rates, is so substantial as to justify a phasing constraint. Exceptional rate increases of this magnitude, even if otherwise justified by constrained market pricing principles, threaten to cause the very economic dislocations that the phasing constraint is intended to mitigate.

Although the raw magnitude of the rate increase itself is significant, the most severe economic dislocations are a consequence of the [REDACTED] % difference between the Lee Ranch and McKinley rail rates to the Cholla Station. (Kelly V.S. at 7) The Lee Ranch and McKinley Mines are the two principal suppliers of coal to the Cholla Station and are the principal suppliers of coal from the San Juan Basin, which places them in direct competition with one another. (Id. at 2) Prior to January 1, 2003, the Lee Ranch rail rate was only [REDACTED] % above the McKinley rate. (Id. at 7) While the greater distance to the Lee Ranch Mine potentially could explain that differential, it cannot explain a [REDACTED] differential.

This gross disparity in rail rates has placed the Lee Ranch Mine at a severe competitive disadvantage to the McKinley Mine, because its competitiveness is highly dependent upon the rail transportation rate. (Id. at 2, 7) The Lee Ranch Mine is highly productive [REDACTED]
[REDACTED]. (Id. at 2)
[REDACTED]
[REDACTED] (Id.) [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] (Id.) Thus, it is essential that Lee Ranch coal have a delivered price [REDACTED] to remain competitive in the southwest. (Id.)

As a component of delivered costs, fair rail rates are essential for the Lee Ranch Mine to maintain its competitive position in this market. (*Id.*)

This competitive disadvantage already is evident. Peabody had expected to sell [REDACTED] tons of coal to Cholla in 2004, which would have resulted in approximately [REDACTED] in revenue. (*Id.* at 4, 8) [REDACTED]
[REDACTED]
[REDACTED]. (*Id.* at 8) Peabody simply cannot absorb the rail rate increase profitably. (*Id.*) Moreover, even if Peabody could absorb the higher rail cost, it still would lose approximately [REDACTED] in revenue annually until the Board issues a final decision. (*Id.*) This revenue would be lost even if APS ultimately prevails in its rate complaint because Peabody is not entitled to reparations.

Peabody cannot readily replace its lost sales to Cholla with sales to other customers, because there are few other potential customers for Lee Ranch coal. Peabody already sells coal from Lee Ranch to five of the nine large coal fired power plants in the region, namely the Salt River Project's Coronado Station, TriState Generation's Escalante Plant, Arizona Electric Power Cooperative's Apache Plant, and Tucson Electric Power Company's Springerville Station. (*Id.* at 2-3, 9) Peabody would have to displace existing suppliers already under contract with these plants. (*Id.* at 9) Three of the remaining coal fired power plants in the region are mine mouth, or captive, power plants (San Juan, Four Corners, and Navajo). (*Id.* at 3) The remaining coal fired plant (Irvington) and other industrial plants in the region are designed to burn coals of substantially higher quality [REDACTED] (*Id.*) Consequently, Lee Ranch coal cannot be burned at these facilities. In the final analysis, however, it is irrelevant whether

Peabody can replace lost APS sales with sales to other coal customers, since the Lee Ranch Mine has sufficient reserves to supply both APS and additional customers. (Id. at 9)

If Peabody is unable to replace lost coal sales to Cholla from the Lee Ranch Mine, there also may be economic consequences for workers at the Mine. [REDACTED]

[REDACTED] Peabody could be forced to shut down the Mine for [REDACTED] based on current production rates of [REDACTED] (Id.) [REDACTED]

[REDACTED] the consequent reduction in forecasted sales of [REDACTED] could force Peabody to shut down the Mine for [REDACTED] or curtail mining activities by reducing its work force. (Id.)

Furthermore, Peabody has made an economic investment of [REDACTED] in the Lee Ranch mine over the last ten years, of which 50% has been expended since 2000. (Id. at 2, 7) Much of this capital was invested in order to maintain the competitive position of the mine. (Id.) The loss of immediate sales in 2003 and 2004, and future sales, would greatly impede the recovery of these investments. (Id. at 7) Additionally, Peabody has expended considerable resources to hire and train [REDACTED] employees to support this investment. The loss of near and long-term sales to Cholla will require the Lee Ranch Mine to revise its mining plan and eventually reduce its work force. (Id.)

Finally, the impact of Peabody's requested relief upon BNSF's short term revenue requirements will be minimal. From a reading of the agency's decision in Coal Rate Guidelines, a phasing constraint does not involve an accounting order to make the prevailing party whole at the conclusion of the proceeding. Rather, a phasing constraint could deny a railroad revenues

during the phasing period from an “otherwise justified” rate increase, without any recourse to collect that money at a later date. Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d at 546. Unlike that situation, Peabody has requested an accounting order that would make BNSF whole, if the Board concludes its rate increase is otherwise justified, at the conclusion of this proceeding.⁶ Therefore, BNSF will not be deprived of any revenue to which it ultimately may be entitled. In addition, BNSF’s willingness to agree to an accounting order in the McKinley Case suggests that a similar order in this proceeding would not be detrimental to BNSF’s short-term revenue requirements.

These facts collectively demonstrate with specificity Peabody’s need for rate relief in the form of a phasing constraint. Lee Ranch coal simply cannot compete with McKinley coal at the increased rail rates in BNSF 90040-A. This is particularly true when BNSF’s rail rates from the McKinley Mine, the principal competitor to the Lee Ranch Mine, are capped by the STB while BNSF is allowed to exercise its ratemaking initiative from Lee Ranch to Cholla free of regulatory constraints. (Kelly V.S. at 7) As a consequence, Peabody will suffer severe irreparable harm. In contrast, an accounting order will protect BNSF from any potential loss of revenue from the phasing constraint. The balance of the equities, therefore, favor granting Peabody’s request for a phasing constraint.

III. BNSF’S RATE INCREASE WILL CAUSE PEABODY IRREPARABLE HARM THAT SHOULD ALSO BE REMEDIED BY 49 U.S.C. § 721(b)(4).

The Board also may grant Peabody relief pursuant to its broad authority under 49 U.S.C. § 721(b)(4) to prevent irreparable harm. Section 721(b)(4) states that the Board may “when

⁶ Although the phasing constraint does not require a keep account order, Peabody has requested one because that is all that is necessary to restore the competitive market status quo between the McKinley and Lee Ranch Mines. Furthermore, because APS intends to use a common stand-alone railroad to determine a maximum reasonable rate from both mines, the rates ultimately determined to be reasonable in both cases are unlikely to result in the same level of harmful disparity that currently exists because the Lee Ranch rate was allowed to rise while the McKinley rate was not.

necessary to prevent irreparable harm, issue an appropriate order without regard to subchapter II of chapter 5 of title 5.” Subchapter II of chapter 5 of title 5, 5 U.S.C. § 551 et seq., is commonly known as the Administrative Procedure Act (“APA”). Thus, relief granted pursuant to 49 U.S.C. § 721(b)(4) is not subject to the usual rules applicable to the issuance of agency orders or to the adjudicatory and other requirements of the APA. See DeBruce Grain, Inc. v. Union Pac. R.R. Co., STB Docket No. 42023 (served Dec. 22, 1997). Section 721(b)(4), by itself, provides adequate authority for the Board to grant Peabody’s request for relief, and it also provides a mechanism for the Board to impose the phasing constraint requested in Part II, supra.

In DeBruce Grain, the Board recognized the following four generally accepted criteria for injunctive relief: (1) substantial likelihood of success on the merits; (2) irreparable harm in the absence of the requested relief; (3) issuance of the order will not substantially harm other parties; and (4) granting the relief is in the public interest. Id., citing Washington Metropolitan Area Transit Comm’n v. Holiday Tours, 559 F. 2d 841 (D.C. Cir. 1977) (“Holiday Tours”). The second, third and fourth criteria already are captured in the factors that the Board considers when determining the need for a phasing constraint, while the first criteria is irrelevant to that determination. Peabody makes each of the necessary showings below.

A. Substantial Likelihood of Success on the Merits.

The necessary showing of likely success on the merits “is governed by the balance of equities as revealed through an examination of the other three factors.” Holiday Tours at 844.

Thus, the D.C. Circuit concluded, in Holiday Tours at 843, that:

A court, when confronted with a case in which the other three factors strongly favor interim relief may exercise its discretion to grant a stay if the movant has made a substantial case on the merits. The court is not required to find that ultimate success by the movant is a mathematical probability, and indeed, . . . may grant a stay even though its own approach may be contrary to

movant's view of the merits. The necessary "level" or "degree" of possibility of success will vary according to the court's assessment of the other factors.

See also, Hamilton Watch Co. v. Benrus Watch Co., 206 F. 2d 738, 740 (2d Cir. 1953) (If the balance of the hardships tips decidedly toward the plaintiff, "it will ordinarily be enough that the plaintiff has raised questions going to the merits so serious, substantial, difficult and doubtful, as to make them a fair ground for litigation and thus for more deliberative investigation.").

Peabody is not in a position to assess APS's ultimate likelihood of success on the merits. However, the Lee Ranch movement to Cholla encompasses the entire route of the McKinley movement plus approximately 70 additional miles. APS previously obtained a prescribed rate for the McKinley movement in the McKinley Case, which the Board recently reopened to consider changed circumstances. It is reasonable to presume that results of both the McKinley Case and the Lee Ranch Case will be closely related. These facts indicate that APS at least has raised fair grounds for litigation. In any event, as demonstrated in Part II, supra, and Parts III.B., C., and D., infra, Peabody has made such a strong showing for relief among the other three factors, that the overall balance of the equities support the requested relief, regardless of the likelihood of success on the merits. E.g., Holiday Tours at 843 (Although plaintiff not entitled to a stay on a showing of likely success on the merits, the other three factors warranted a stay.).

An alternative, and perhaps more appropriate, view of the likely success on the merits is whether Peabody is likely to succeed on the merits of its phasing constraint argument in Part II, supra, for an injunction during the pendency of this proceeding. Because the basis for Peabody's relief is the economic dislocations that are causing it irreparable harm, Peabody's likelihood of success on the merits is based on demonstrating irreparable harm. The relevant factors considered in a phasing constraint analysis (e.g., magnitude of rate increase, economic conditions

in the destination market and coal supply area, short term revenue requirements of the railroad) are all consistent with an irreparable harm analysis and subsume each of the other three Holiday Tours factors. Therefore, in demonstrating the strength of the second, third, and fourth factors, Peabody has proven its likelihood of success on the merits.

B. Peabody Will Suffer Irreparable Harm If It is Denied the Requested Relief.

Peabody already has demonstrated irreparable harm in Part II, supra, in support of its request for a phasing constraint. In summary, if BNSF is allowed to increase its rate from the Lee Ranch Mine to Cholla, but is prohibited from increasing its rate from the McKinley Mine, the resulting discrepancy in rail rates from these two competing mines will place Peabody's Lee Ranch Mine at a significant competitive disadvantage. As a consequence, Peabody will lose up to [REDACTED] tons annually in existing coal sales to the Cholla Station.

The dramatic, sudden, and unexpected increase in the rail rate from the Lee Ranch Mine, all by itself, also constitutes irreparable harm. The Board reached this conclusion as to APS in the May 12 Decision on the basis of a 64% increase in the rail rate from the McKinley Mine, and it should reach a similar conclusion as to the [REDACTED] to [REDACTED]% increase in the Lee Ranch rail rate. While APS, as the rail ratepayer, can be made whole through reparations, Peabody cannot. Thus, the harm to Peabody in this proceeding is even greater than the harm to APS in the McKinley Case, which the Board concluded was sufficient to justify injunctive rate relief.

Further, Peabody will be irreparably harmed due to the fact that it has invested [REDACTED] [REDACTED] in the Lee Ranch Mine over the last ten years in order to maintain the competitive position of the Mine. The loss of immediate sales in 2003 and 2004, and future sales, would greatly impede the recovery of these investments and force the Mine to reduce its work force, which would result in irreparable harm to Mine employees.

C. The Requested Relief Will Not Substantially Harm Other Parties.

Because Peabody has requested an accounting order as part of its requested rate relief, no other party will be substantially harmed. At the conclusion of this proceeding, either APS or BNSF will be made whole, depending on the maximum reasonable rate ultimately prescribe by the Board. Furthermore, BNSF already voluntarily agreed to an accounting order in the McKinley Case and there is no reason to believe that an accounting order in this proceeding would harm BNSF.

D. The Requested Relief is in the Public Interest.

Peabody already has demonstrated that its requested relief is in the public interest in Part II, supra, in support of a phasing constraint. The very purpose of the phasing constraint is to balance “the public need for a sound, healthy rail system with the public need for smooth, orderly economic transitions.” Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d at 546.

The gross disparity between the McKinley and Lee Ranch rail rates to Cholla result in severe economic dislocations because Lee Ranch coal no longer can compete with McKinley coal. As a consequence, the Lee Ranch Mine will irreparably lose most, and potentially all, of its coal sales to the Cholla Station while this proceeding is pending. This disparity is not the result of market conditions; but rather, it is the result of regulatory action that has prohibited BNSF from increasing the McKinley rail rate while allowing it to increase the Lee Ranch rail rate. It is in the public interest to rectify this inequitable situation by entering an order for the movement of coal from Lee Ranch to Cholla that would be consistent with the order that the Board has already entered with respect to the movement of coal from McKinley to Cholla, namely, by enjoining BNSF from collecting a rail rate from Lee Ranch to Cholla above the last applicable contract rate until the Board determines the reasonableness of rates in BNSF 90040-A, subject to keeping

account of all amounts paid during the pendency of this proceeding so that either BNSF or APS may be made whole.

IV. CONCLUSION

Between the “phasing constraint” and 49 U.S.C. § 721(b)(4), the Board possesses ample authority to grant Peabody’s request for relief. Peabody asks only that the Board instruct BNSF not to increase its rate from Lee Ranch to Cholla above the last applicable contract rate until the Board determines the reasonableness of the rates in BNSF 90040-A, subject to keeping account of all amounts paid during the pendency of this proceeding so that either APS or BNSF may be made whole for what it would have been entitled to but for Peabody’s request to maintain the status quo. This is precisely the relief that the Board granted to APS in the McKinley Case, based solely on Section 721(b)(4). Since Peabody’s Petition is based upon the gross disparity in rail rates to Cholla from the Lee Ranch and McKinley Mines created by the Board’s May 12 Decision, this is the bare minimum relief that is necessary to avoid irreparable harm to Peabody, because it restores the market-based status quo that was in place prior to BNSF’s Petition to Reopen the McKinley Case and APS’s Complaint in this proceeding.

Respectfully submitted,



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*Counsel for Intervenor,
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June 16, 2003

CERTIFICATE OF SERVICE

I, Pamela D. Plummer, a secretary at the law firm of Thompson Hine LLP, do hereby certify that on this 16^h day of June, 2003, a copy of the Petition for Injunctive Relief, was hand delivered to the following:

Samuel M. Sipe, Jr.
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Washington, D.C. 20036

*Attorney for The Burlington Northern and Santa
Fe Railway Company*

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Washington, D.C. 20006

*Attorney for Arizona Public Service Company and
PacifiCorp*


Pamela D. Plummer

*by hand

CERTIFICATE OF SERVICE

I, Pamela D. Plummer, a secretary at the law firm of Thompson Hine LLP, do hereby certify that on this 20th day of June, 2003, a copy of the replacement pages within Exhibit 2, the Verified Statement of Tom O'Connor of the Petition for Injunctive Relief, was hand delivered to the following:

Samuel M. Sipe., Jr.
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Pamela D. Plummer

EXHIBIT 1

PUBLIC VERSION
HIGHLY CONFIDENTIAL AND CONFIDENTIAL MATERIAL REDACTED

BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. 42077

ARIZONA PUBLIC SERVICE COMPANY AND PACIFICORP

v.

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY

VERIFIED STATEMENT OF COLIN KELLY

My name is Colin Kelly and I am the Vice President Southwest Sales for Peabody COALSALSALES Company, which is the coal sales marketing subsidiary of Peabody Energy Corporation (“Peabody”). My business address is 701 Market Street, St. Louis, Missouri 63101. I am responsible for all coal sales in the southwestern United States, which encompasses California, Nevada, Utah, Colorado, New Mexico and Arizona. I also am a professional mining engineer with over twenty years of experience in the coal and power industries. I am submitting this Verified Statement in support of Peabody’s “Petition to Intervene,” “Petition for Injunction,” and “Motion for Expedited Consideration” in the above-captioned proceeding.

I. DESCRIPTION OF PEABODY AND THE LEE RANCH MINE.

Peabody is a private sector coal company. It owns a majority interest in 33 coal operations located in the Powder River Basin, Southwest, Appalachia and Midwest coal producing regions. As it pertains to this Surface Transportation Board (“STB” or “Board”)

proceeding, Peabody owns and operates the Lee Ranch Mine ("Mine") through a wholly owned subsidiary, Lee Ranch Coal Company. The Mine, which is located near the town of Grants in northwestern New Mexico, employs 300 workers and annually injects more than \$34 million into the New Mexico economy in royalties, taxes, wages and charitable contributions. The Mine recovers coal from 26 seams that lace a 170 million ton reserve in the San Juan Basin. In 2002, the Mine shipped 6.3 millions tons of coal. Within the last 10 years, Peabody has invested over \$[REDACTED]¹ in the Lee Ranch Mine, of which half has been invested since 2000. This capital was invested, in large part, to maintain the competitive position of the Mine [REDACTED]

Lee Ranch coal competes primarily with coal from the McKinley Mine, the other major San Juan Basin coal producer, and coal from Colorado and Powder River Basin mines. The competitiveness of Lee Ranch coal, and thus its market, is highly dependent on the rail transportation rate. Although the Mine is highly productive [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] a fair rail rate is essential to the competitiveness of Lee Ranch coal.

¹ The shaded text is highly confidential and confidential material that has been redacted from the public version of this filing.

The Mine currently sells coal to five of the nine large coal fired power plants in the region. These plants are the Cholla Station, owned by Arizona Public Service Company; the Coronado Station, owned by Salt River Project; the Springerville Station, owned by Tucson Electric Power Company; the Escalante Station, owned by TriState Generation; and the Apache Station, owned by Arizona Electric Power Cooperative. Three of the remaining four coal-fired power plants in the region – San Juan, Four Corners, and Navajo – are mine mouth plants. The final plant, Tucson Electric’s Irvington Station, along with most coal-burning industrial facilities, is designed to burn substantially higher quality coal than the Lee Ranch Mine can produce. Thus, Lee Ranch coal cannot be used by the four southwestern plants that do not currently burn it.

II. THE RELATIONSHIP BETWEEN THE LEE RANCH MINE AND THE CHOLLA STATION.

A. Description of the Cholla Station.

Arizona Public Service Company (“APS”) and PacifiCorp jointly own the Cholla Station. The Cholla Station is comprised of four units that have a total net output of approximately 1100 MW and burn approximately 3.5 to 4 million tons of coal annually. APS owns units 1, 2 and 3; PacifiCorp owns unit 4; and APS operates all four units. Unit 1 is 114 MW and fully scrubbed. Units 2 and 3 are 285 MW each. Unit 2 is 67% scrubbed, while Unit 3 has no scrubbing. Both units have a bubble permit that limits their combined emissions to 0.8 #SO₂/mmbtu. Unit 4 is 414 MW with a 33% scrubber.

Cholla must burn coal from four different sources due to the vintage and permit constraints of each unit. The vast majority of coal burned at Cholla comes from the McKinley Mine pursuant to a long term contract that extends through 2012.² The Lee Ranch Mine is the second largest coal supplier to the Cholla Station, providing 15-18% of its total coal

² RDI Database.

consumption. APS also purchases lesser amounts of coal from the Colowyo Mine in Colorado, [REDACTED], and from the Spring Creek Mine in Montana [REDACTED]. In 2002, APS purchased 3.2 million tons from McKinley, 637,000 tons from Lee Ranch, 113,000 tons from Colowyo, and 81,000 tons from Spring Creek.³

B. Historical and Projected Coal Sales from Lee Ranch to Cholla.

The Lee Ranch Mine has supplied coal to Cholla since 1997. The current coal supply agreement was effective in October 2000, expired on December 31, 2002, and subsequently was renewed [REDACTED] [REDACTED]. Although APS and Peabody have held preliminary discussions on a contract for 2004 and beyond, formal negotiations will not commence until late this Summer.

Peabody's most recent projections of future coal sales to Cholla from the Lee Ranch Mine anticipated [REDACTED]. Specifically, Peabody has forecasted sales of [REDACTED] tons [REDACTED]. [REDACTED] The substantial rail rate increases imposed by BNSF in January 2003, however, have forced Peabody to revise those projections drastically downward [REDACTED] [REDACTED].

C. Rail Transportation from Lee Ranch to Cholla.

Prior to January 1, 2003, the BNSF transported coal from Lee Ranch to Cholla pursuant to a four-year contract designated BN-C-12203. According to information from APS, the last effective rate under that contract was in the neighborhood of \$ [REDACTED] per ton.⁴ Peabody also

³ RDI Database.

⁴ Because BNSF-C-12203 was a confidential contract, Peabody does not know the precise rate. However, based on publicly available delivered cost information and the coal supply agreement between APS and Peabody, the last effective contract rates appears to have been in the neighborhood of \$ [REDACTED] per ton.

understands that [REDACTED]

[REDACTED]

[REDACTED] [REDACTED]

[REDACTED].

APS and BNSF were unable to agree on terms for a new contract, beginning January 1, 2003.

In anticipation of the expiration of BN-C-12203, BNSF published rates and terms applicable to the Lee Ranch to Cholla movement in BNSF Common Carrier Pricing Authority BNSF 90040-A, Supplement No. 4 ("BNSF 90040-A"), beginning January 1, 2003. BNSF immediately increased the rail rate nearly [REDACTED]%, from \$[REDACTED] per ton to \$8.62. In addition, BNSF imposed a 2.0-2.5% fuel surcharge, which adds 17-21¢ to the rate. BNSF also has indicated that it may begin to collect the \$600 per hour demurrage charge for unloading time in excess of 24 hours, which effectively adds \$2.00 per ton to the rail rate. The cumulative effect of these charges will be an increase in the rail rate from \$[REDACTED] per ton to \$[REDACTED], or nearly [REDACTED]%. In January 2003, APS challenged the reasonableness of the rates in BNSF 90040-A by filing a Complaint with the STB. Until the STB resolves the Complaint, however, BNSF is allowed to collect the increased rates, subject to paying reparations to APS if the STB ultimately prescribes a lower rate.

There are no practical or economically feasible alternatives to BNSF for the transportation of coal from Lee Ranch to Cholla. BNSF is the only railroad with access to either the Mine or Cholla, and the nearest alternative railroad is more than 250 miles away from either location. There is no navigable waterway near either location. Trucks also do not provide a feasible alternative to rail. Even assuming that APS could overcome objections from state highway authorities, Peabody estimates the cost of trucking coal to Cholla would exceed \$14 per

ton. It is my understanding that the STB previously concluded that trucks were not competitive with BNSF for the movement of coal from the McKinley Mine to Cholla. Trucks from the Lee Ranch Mine would have to follow the same route, but for a much greater distance. Therefore, trucks would be even less competitive from the Lee Ranch Mine.

D. Comparison with Rail Transportation from the McKinley Mine.

The primary supplier of coal to the Cholla Station, and the principal competitor to the Lee Ranch Mine, is the McKinley Mine. The McKinley Mine is located approximately 60 miles due west of the Lee Ranch Mine, near the Arizona/New Mexico border.

BNSF transports coal from McKinley to Cholla along the same route used for Lee Ranch to Cholla coal movements. Since 1994, the STB has prescribed a rate for BNSF's transportation of coal from McKinley to Cholla. That rate currently is \$4.21 per ton; it is not subject to fuel surcharges; and Peabody believes that it may not be subject to demurrage charges. The STB had prescribed rates through 2013.

In January 2003, BNSF asked the STB to reopen its prior decision and to lift the rate prescription for the McKinley Mine to Cholla movement in order to allow BNSF to increase the rate by 64%, to \$6.91 per ton. This rate increase would have been contemporaneous with BNSF's ■% increase in the Lee Ranch Mine to Cholla rail rate. The new McKinley rate also would have been subject to the same fuel surcharge and demurrage charges as the Lee Ranch rate. In a decision served on May 12, 2003, however, the STB instructed BNSF to collect no more than the previously prescribed rate of \$4.21 per ton, subject to an accounting order that would require APS or BNSF to pay reparations to the other based upon the maximum reasonable rate ultimately prescribed by the Board in the reopened proceeding. Thus, although BNSF has

been allowed to raise its Lee Ranch to Cholla rate immediately by [REDACTED]%, it has been prohibited from imposing a 64% increase on the McKinley rate.

III. CONSEQUENCES OF THE CURRENT SITUATION TO PEABODY.

Since January 1, 2003, and continuing through the conclusion of APS's rate complaints regarding the McKinley and Lee Ranch rates to the Cholla Station, the BNSF rail rate from Lee Ranch to Cholla effectively has risen [REDACTED]%, while the McKinley to Cholla rail rate has remained unchanged at \$4.21 per ton, and cannot be increased at all until a final STB decision. The Lee Ranch rail rate, which was [REDACTED] % above the McKinley rail rate of \$4.21 on December 31, 2003, is now [REDACTED] % greater.⁵ The magnitude of this difference has decimated the ability of Lee Ranch coal to compete with McKinley coal for sales to the Cholla Station. In addition, the increased rail rate will put the Lee Ranch Mine at a competitive disadvantage to Colorado and PRB coal at Cholla.

[REDACTED] Lee Ranch coal must have a delivered price that is substantially below other mines in order to remain competitive. Peabody has invested [REDACTED] in the Lee Ranch Mine over the last ten years [REDACTED] [REDACTED] But, the sudden and dramatic [REDACTED] % increase in the BNSF's rail rate has made the delivered price of Lee Ranch coal non-competitive at Cholla, by increasing the difference between the McKinley and Lee Ranch rates from [REDACTED] to [REDACTED] Moreover, it has severely impaired Peabody's ability to recover its [REDACTED] investment in the Mine. As part of that investment, Peabody hired [REDACTED] additional employees, who could be laid off if the loss of near and long-term sales forces the Mine to revise its mining plan to reflect the reduced tonnage.

⁵ When the fuel surcharge and demurrage charges are excluded, the rate difference is [REDACTED] % versus [REDACTED] % when they are included.

Peabody may begin to feel the adverse effects of the higher rail rate at the Mine in 2003.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Peabody could be forced to shut down the Mine for [REDACTED] based on current production rates of [REDACTED]

[REDACTED]

[REDACTED] APS may drastically reduce, if not eliminate, its coal purchases from the Lee Ranch Mine in 2004. [REDACTED]

[REDACTED] Peabody simply cannot absorb the [REDACTED] % increase in the rail rate. This means that Peabody stands to lose [REDACTED] tons of expected coal sales to Cholla in 2004, which would equal approximately [REDACTED] in revenue. This amount would increase in subsequent years, when Peabody has projected [REDACTED] to [REDACTED] tons in coal sales. At current coal production rates, Peabody could have to shut down the Mine for [REDACTED] or curtail mining activities by reducing the work force, if it loses these sales.

Some of these future tons already may be irretrievably lost until at least 2008, even if the Board issues a decision in this proceeding sooner. The increased sales projections are based in part on [REDACTED]

[REDACTED]

[REDACTED] However, because the rail rate increase has made the delivered cost of Lee Ranch coal non-competitive for the 2-3 year duration of a typical rate case, [REDACTED]

[REDACTED]

Thus, the adverse effects of the increased rail rate already is being felt by Peabody and is likely to be felt long after the conclusion of this proceeding.

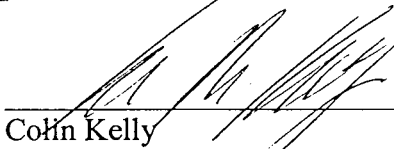
Peabody cannot readily replace these lost tons with coal sales to other customers. Peabody already is selling Lee Ranch coal to five of the nine major coal-fired power plants in the region, and for reasons previously discussed, cannot sell to the remaining four. Furthermore, Peabody would have to displace existing suppliers under contract at these power plants, or obtain new business from increased coal consumption by these power plants, in order to make up the lost tons. Peabody's ability to compete for this business still would depend upon BNSF establishing a fair and reasonable coal rate that would allow Lee Ranch coal to be competitive. More importantly, however, even if Peabody could replace the lost sales to Cholla, Peabody still irreparably would lose revenue because the Lee Ranch Mine has sufficient reserves to sell coal to Cholla and to additional customers.

IV. CONCLUSION.

These harms are the direct result of a gross disparity in rail rates to Cholla from the Lee Ranch and McKinley Mines. Although BNSF attempted to increase rates on both movements contemporaneously, it only has been allowed to increase the Lee Ranch rate. The resulting rate differential of ██████% has rendered Lee Ranch coal non-competitive with McKinley coal for sales to the Cholla Station. Furthermore, the rail rate increase has enhanced the competitiveness of Colorado and Powder River Basin coals at Cholla. These disparities are not caused by any market factors, but are the result of regulatory action and/or inaction. If this artificial rate disparity is allowed to continue through the conclusion of the APS challenges to BNSF's rates from McKinley and Lee Ranch to Cholla, Peabody will suffer substantial and irreparable harm.

VERIFICATION

I, Colin Kelly, verify under penalty of perjury, under the laws of the United States, that the foregoing statements are true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement. Executed on this 6 day of June, 2003.



Colin Kelly
Vice President Southwest Sales
Peabody Coal Sales Company

EXHIBIT 2

SK Snavely King Majoros O'Connor & Lee, Inc.

BEFORE THE
SURFACE TRANSPORTATION BOARD

ARIZONA PUBLIC SERVICE COMPANY AND PACIFICORP,	)	
Complainant,	)	
	)	Docket
	)	No. 42077
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY CO	)	
Defendant,	)	

OPENING VERIFIED STATEMENT OF
TOM O'CONNOR
Vice President
Snavely King Majoros O'Connor & Lee, Inc.
1220 L Street, N.W.
Washington, D.C.

Submitted On Behalf of
Peabody Energy Company
June 16, 2003

Verified Statement of Tom O'Connor • Docket No. 42077

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SK **Snavely King Majoros O'Connor & Lee, Inc.**

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VERIFICATION

 49

I. INTRODUCTION AND STATEMENT OF QUALIFICATION

My name is Tom O'Connor. I am Vice President of Snavely King Majoros O'Connor & Lee, Inc. (SK), an economic consulting firm with offices at 1220 L Street, N.W. in Washington, D.C. I have been engaged in the study of transportation economics for more than twenty-five years.

My professional career began in 1973 as an economist with the Interstate Commerce Commission, the predecessor to the Surface Transportation Board (STB). Subsequently, I have held increasingly responsible management positions in transportation, government, industry and consulting.

I have previously provided testimony on transportation economics, costing, design and use of the waybill sample, and other issues before the Surface Transportation Board, the U.S. Railway Association and federal and state courts. In considering the issues in this case I have drawn on much of my experience in designing, implementing and computerizing transportation costing systems. At the Interstate Commerce Commission, as an economist, I analyzed cost issues as they affected both individual rate cases and ICC policy issues.

Subsequently, as Manager of Local Rail Planning for the United States Railway Association, I applied cost principles in designing and implementing the cost system used to define much of the Conrail network.

At Conrail, as Assistant Director of Costs and Economics, I had primary responsibility for evaluating thousands of rates, and every possible configuration of

rail service. I developed and applied systems to simulate reliably the cost consequences of actions and policies both in effect and under consideration. This focus on costs continued as Assistant Vice President of Economics for the Association of American Railroads. In that position I led an industry wide program to help design and advise on the development of URCS, which is now in use throughout the rail industry.

Since 1982, as a consultant to railroads, railroad shippers and government agencies, I have served as expert adviser and led and assisted in numerous costing projects in the United States, in Canada and overseas in the Balkans in Eastern Europe. Costing systems that I have helped develop are in widespread use.

This background was brought to bear as appropriate to the proper treatment of issues presented in this case. A full statement of my qualifications appears in Attachment A.

II. PURPOSE OF TESTIMONY AND SOURCES OF DATA

In this proceeding, I have been asked by Peabody Energy Company ("PEC") to perform two analyses.

First, I have been asked to compute the variable costs incurred by the Burlington Northern Railroad Company ("BN") in transporting coal between the Lee Ranch Mine in New Mexico and the Cholla Electric Steam Generation Station ("Cholla"), near Joseph City Arizona. This first analysis was developed on the basis of

publicly available data without access to, or use of, any confidential material.

Within these constraints, in my analysis I have used the most accurate and reliable data describing the transportation of this coal both as to service units and unit costs. Much of the cost and other data specific to the PEC coal movement was derived from the public record in Docket No. 42077. For some items in this Opening Statement, I have used standard Year 2001 Uniform Rail Costing System (URCS) factors. URCS factors reflect average variable costs. Rail transportation of coal tends to be a high density, high volume and low cost operation. Accordingly, to the extent standard URCS factors have been used they tend to understate the economies produced and the profits generated by this unit train transportation of coal.

Second, I have been asked to estimate the rail rate increase that was imposed by the rail carrier in the case of four shippers of coal who have recently challenged the common carrier rail rate before the Surface Transportation Board (STB). I then compare the experience of these shippers to the rail rate increase that was imposed on the Lee Ranch coal movement in this case. For the second analysis, in which I estimate the rail rate increases on shipments in other recent STB rate reasonableness proceedings to four other coal burning utility power plants, I have relied on data available in the public record. This analysis of rate increases to other utilities provides important insights on the magnitude of the rate increases applied to the Lee Ranch shipments by The Burlington Northern Santa Fe Railroad (BNSF).

III. VARIABLE COST OF TRANSPORTING COAL FROM LEE RANCH TO CHOLLA

Arizona Public Service Company ("APS") operates the Cholla Station, which consists of four coal-fired units with a total net output of approximately 1000 MW. The Cholla station consumes 3.5 to 4 millions tons of coal per year. Cholla is located near Joseph City in Arizona. Much of this coal has been supplied from the Lee Ranch Mine, ("Lee Ranch") which is owned and operated by the Lee Ranch Coal Company, a subsidiary of Peabody Energy Company ("PEC").

In this proceeding, APS seeks the establishment of reasonable rates for the transportation of coal in unit trains. Using data available from the public record, my cost analysis produces a conservative estimate of BNSF's operating and cost experience. Based on experience and extensive prior cost analyses, this conservative analysis does not reflect all the efficiencies and cost savings available to BNSF through unit train operations. Some of those savings areas are discussed in the following section.

For example, I have structured the variable cost analysis using only public data and system averages, rather than the specific costs associated with the more efficient locomotives used in unit train coal service. Accordingly, the greater efficiencies available from the SD70 (4,000 hp) and other advanced locomotives are submerged into the average variable costs produced by URCS. This is a significant reason why the variable cost calculations presented here should be considered conservative.

My variable cost analysis is straight forward and has one simple objective, namely,

measuring BNSF's variable costs in providing unit train coal service from the Lee Ranch Mine to the Cholla Station. The analysis is reported in the following sections:

- ☐ Findings
- ☐ Operating Characteristics
- ☐ Variable Costs
- ☐ Conclusions and Summary

A. Findings

The analysis resulted in several findings, which can be summarized as follows:

1. The variable cost incurred by BNSF in transporting coal from the Lee Ranch Mine to the Cholla plant in railroad owned cars loaded to 95 tons is \$2.83 per ton at 2001 cost levels, and is \$2.41 per ton in railroad owned cars loaded to 116 tons. These results and their derivation is shown in Exhibit ____ (TOC-01).
2. Compared to the rate of \$8.75 per ton for the 95-ton lading published by BNSF in BNSF Price List 90040-A, the variable cost of service in BNSF equipment produces a revenue-variable cost ratio (RCR) of 309%.
3. Compared to the rate of \$8.62 per ton for the 116-ton lading published by BNSF in BNSF Price List 90040-A, the variable cost of service in BNSF equipment produces a revenue-variable cost ratio (RCR) of 357%.

In fact, the actual RCR's are likely even higher than these estimates for two

reasons; the actual costs may be lower and BNSF may push the rate higher. As noted previously in this testimony, my analysis does not reflect many well established cost reductions because I have confined the data to that available in the public record. Moreover, in its pricing authority BNSF holds out the possibility of further rate increases. For example, BNSF asserts in BNSF Price List 90040-A that the freight rates are subject to being increased by a fuel surcharge.

B. Operating Characteristics

BNSF provides unit train transportation of coal to the Cholla plant from three (3) mines:

- ☐ Lee Ranch Mine, New Mexico
- ☐ McKinley Mine, New Mexico
- ☐ Spring Creek Mine, Nerco Jct. MT

The Lee Ranch mine is the origin of the shipments analyzed in this verified statement and Cholla Station is the destination of the shipments analyzed in this verified statement. The transportation was evaluated based on unit trains containing 100 railroad owned cars each carrying an average of 95 or 116 tons; data corresponding to BNSF Common Carrier Pricing Authority BNSF 90040-A.¹

Coal is transported to Cholla using a mix of aluminum and steel open hopper cars. The lighter weight aluminum cars are loaded more heavily with coal. Both steel and aluminum cars are loaded to track weight capacity. As noted above, the average lading ranges from 95 to 116 tons per car, and the average freight car tare

¹ BNSF Pricing authority calls for a minimum tender of 99 railcars for transport to Cholla

weight as provided by Peabody is 24.9 tons.

The variable unit costs of the transportation service have been computed using the standard STB URCS cost model, modified within the range of publicly available data to reflect some of the specifics and efficiencies of the PEC coal movement. These unit costs are multiplied by the appropriate service units as computed in URCS Phase III and modified by SK as described in the next section to produce the cost components and total variable costs of providing the service to Cholla station.

Within the limits of publicly available data, SK has been able to develop reliable adjustments of both service units and unit costs, to better reflect the economies and efficiencies of unit train service to Cholla. The adjustments are based on information drawn from:

- BNSF public reports
- PEC observations of train consists
- The public record, and
- Other sources as documented in my workpapers.

The Commission's April 7, 1982 decision in Potomac Electric Power Company v. Consolidated Rail Corporation (Docket No. 36114 (Sub No. 1), Appendix A) contains an outline of the operating characteristics that should be accounted for in determining variable costs for a unit train coal movement such as that at issue here. I present on the following pages a list of the forty-two (42) items shown in the Peppo Appendix, as each relates to the PEC Lee Ranch mine to Cholla coal

movement. Some data items are not applicable to the level of analysis, which SK conducted relying strictly on public data. Those items are marked Not Applicable.

Operating Characteristics for Lee Ranch to Cholla Station Coal Train

<u>Item</u>	<u>Characteristics</u>
1. Origin and Destination	Lee Ranch Mine, NM To Cholla Station Not Applicable
2. Milepost at Origin, Milepost at Destination	Not Applicable
3. Annual tons	Not Applicable
4. Date of first shipment	Not Applicable
5. Alpha-numeric car type	H351/J311 ²
6. Weight of lading per car	95 to 116 Tons
7. Tare weight of car	24.9 Tons
8. Identity of car owner	Railroad
9. Identity of locomotive owner	BNSF ³
10. Car lease rental (RR supplied cars)	URCS System Average
11. Locomotive lease rental (if any)	URCS System Average
12. Present rate	\$8.62 to \$8.75 per ton
13. Proposed rate	Not Applicable
14. Initial rate and effective date	Not Applicable
15. Amounts (or percent) of rate escalation	Not Applicable
16. Cars per train	100

² Association of American Railroads ("AAR") car type codes H351 (steel) and J311 (aluminum).

³ BNSF owns or leases the locomotives used to transport coal to Cholla Station

Operating Characteristics for Lee Ranch to Cholla Station Coal Train

	<u>Item</u>	<u>Characteristics</u>
17.	Loaded miles	193
18.	Empty miles	193 ⁴
19.	Length of Origin loop track	44 miles ⁵
20.	Length of Destination loop track	2 mi.
21.	Number of locomotive units	5
22.	Loading hours	4
23.	Unloading hours	4
24.	Cycle time (hours)	Not Applicable
25.	Number of trainsets required	Not Applicable
26.	Trips per year per trainset	Not Applicable
27.	Crew districts, loaded direction	Not Applicable
28.	Crew districts, empty direction	Not Applicable
29.	Turnaround crews	Not Applicable
30.	Locomotive units required (type and hp)	5 fleet average units
31.	Cars required	Minimum of 99

⁴ For this rail coal transportation service, the empty miles equal the loaded miles.

⁵ The mine is served by a spur line that departs the BN mainline at Baca, NM. The Baca Spur is 27.3 miles to the Star Lake Switch where the line continues on to two branches, one to the South Hospah Spur and the other to the Lee Ranch mine. From the Star Lake Switch to the Lee Ranch mine is another 12.3 miles. The total miles, including the loop track at the mine, is 44 miles.

Operating Characteristics for Lee Ranch to Cholla Station Coal Train

<u>Item</u>	<u>Characteristics</u>
32. Cabooses	Not Applicable
33. Spare margin -- locomotives	Not Applicable
34. Spare margin -- cars	Not Applicable
35. Spare margin -- cabooses	Not Applicable
36. Switching by road-haul locomotives	Not Applicable
37. Switching by yard locomotives	URCS System Average
38. Helper service	Not Applicable
39. Helper crew	Not Applicable
40. Location of interchanges	Not Applicable
41. Location of intratrain switches	Not Applicable
42. Joint facility payments	URCS System Average

IV. Variable Cost Methodology and Results

In this section, I identify and summarize the variable costs associated with the resources required for the PEC coal movement.

By its September 20, 1989 decision in Ex Parte No. 431, the ICC adopted URCS as the general purpose costing system. Unit costs and costing procedures have been taken directly from the data and methodologies reported to and developed by the STB. The basis of my work is the 2001 BNSF URCS unit costs as derived from BNSF's 2001 Annual Report Form R-1 and other URCS input documents, which is the most recent data available. The URCS cost model, upon which my

estimates are based, is extracted directly from the STB URCS phase II and phase III cost model.

The STB URCS costing system consists of three phases:

- ☐ **Phase I** develops the database of railroad expenses and operating statistics; determines relationships between expenses and measures of output; and estimates the cost variability associated with those relationships.
- ☐ **Phase II** calculates the variable and constant costs of specific service units based on the findings of Phase I.
- ☐ **Phase III** combines system wide service units and unit costs with the specific description of a particular shipment to compute the variable costs of that shipment.

With appropriate adjustments to the Phase II data to reflect efficiencies and economies identifiable from the public record as they relate to the Lee Ranch to Cholla unit coal train movement, I have adopted Phase III as my cost methodology.

In the variable costing description below, I discuss the method employed to cost each functional division of service performed. In discussing each cost area I describe, explain and support any adjustments made. While the specifics of the adjustments may vary, they are linked by a common characteristic: all of the adjustments serve to improve the accuracy of the analysis.

As noted in the preceding section, Exhibit____(TOC-01) reports that the cost for transporting the coal in railroad supplied freight cars, at loadings of 116 tons per car is \$2.41 per ton, stated at 2001 URCS levels. Exhibit____(TOC-01) also reports that the cost data for transporting the coal in railroad supplied freight cars, at loadings of 95 tons per car is \$2.83 per ton, stated at 2001 URCS levels.

The cost per ton reported on Exhibit____(TOC-01), is the summation of the individual variable cost components computed using URCS Phase III with BNSF 2001 unit costs and operating factors combined with the operating parameters associated with the Lee Ranch to Cholla movement.

On Exhibit____(TOC-01) the Total Variable Cost Per Car is divided by the tons per car to produce a Total Variable Cost Per Ton and then indexed to 1Q2003 levels as described below.

The cost results described above all flow from the combination of unit costs and service units. The basic service units are shown on Exhibit____(TOC-02) and Exhibit____(TOC-03) and are described in Section IV of this verified statement.

The unit costs I use are derived from BNSF's 2001 Annual Report Form R-1, as analyzed and formatted in accordance with the URCS worktables. URCS unit costs have three components:

- Operating costs (OPR)
- Depreciation, retirement and leased rental cost (DRL)
- Return on investment (ROI)

Exhibit____(TOC-02) shows the cost result for each cost category, and the underlying unit cost for each of the components of the cost category. Some of the more prominent cost components are discussed below.

A. Freight Car Operating Expenses

Railroad car operating costs are included in the URCS-based railroad owned car cost scenarios. Additional savings are achievable using shipper owned cars.

B. Freight Car Inspection Costs

Using modern equipment, such as defect detectors embedded in the track with voice relay to the locomotive engineer, inspection costs have been dramatically reduced compared to those associated with dedicated yard forces. Such car inspection costs are adequately covered in the URCS line haul costs we have included.

C. Train Mile Costs

For purposes of this initial analysis, train mile costs are included based on URCS system average unit costs. These and all other unit costs used in this analysis are shown on Exhibit____(TOC-02).

D. Terminal-Related Costs and Switch Engine Minutes

Strictly speaking, terminal switching does not occur in the course of the APS Lee Ranch Mine service. Such switching is rendered unnecessary due to the use of a dedicated train at both the origin and destination loop tracks. Taking a somewhat more expansive view of the term in consideration of the practicalities of this analysis however, I have included "Terminal Switch Costs". I included a cost per

engine minute and an engine minutes per car switching factor to reflect terminal switching at the Loop tracks.

E. Ex Parte 270 (Sub No 4) cost adjustments

The station clerical cost per carload handled is a terminal related cost. Relevant economies and efficiencies have traditionally been sourced to one of two studies:

- The Burden Study factor, which reduces the cost to 47 percent of its system average level, and
- The Ex Parte 270 (Sub No 4) adjustment, which associates part of the costs with the shipment and part with the car.

We use the standard Ex Parte 270 (Sub No 4) adjustment associated with unit train operations. The Ex Parte (Sub No 4) adjustment is also used to reduce switch costs and car day costs.

F. Loss and Damage Costs

Loss and damage is not a major cost component for coal. I have used BNSF's standard URCS system average loss and damage unit costs for coal.

G. Indexing Costs to 1Q2003

As noted at the outset, my variable cost analysis was conducted based upon 2001 BNSF unit costs. It is necessary to index the results forward to first quarter 2003 levels, to reflect the time period in which the BNSF tariff prices are applicable.

For indexing purposes, we prefer the Rail Cost Adjustment Factor (RCAF) adjusted for productivity. The appropriateness of recognizing productivity was a major finding and recommendation of the Rail Accounting Principles Board (RAPB). The ICC (now STB) subsequently implemented the RAPB

recommendations with the inclusion of a productivity adjustment in the RCAF cost index computations.

It is, however, appropriate to exclude from cost computations the consideration of assignment of productivity benefits, and instead incorporate in full the RCAF index unadjusted for productivity. While assignment of productivity benefits may be a marketing issue, or a pricing issue, it is not a costing issue.

As computed in Exhibit ____ (TOC-01), the cumulative change in the RCAF from Quarter four of 2001 to Quarter 1 of 2003 is an increase of 2.36%.

Exhibit ____ (TOC-01) reports that the cost data for transporting the coal in railroad-supplied freight cars, at loadings of 116 tons per car is \$2.47 per ton, stated at Q1 2003 levels. Exhibit ____ (TOC-01) also reports that the cost data for transporting the coal in railroad supplied freight cars, at loadings of 95 tons per car is \$2.90 per ton, stated at Q1 2003 URCS levels

H. Conclusions and Summary

The conclusions flow inevitably from the findings and can be stated simply.

- ☐ The costs were computed reliably using standard STB URCS methodologies and data, with some adjustments to reflect actual BNSF cost experience and specifics of the PEC movement. The adjustments were limited to those based on data available in the public record
- ☐ As shown on Exhibit ____ (TOC-01) and indexed as noted above, the analysis demonstrates that after indexing to 1Q03 cost levels, BNSF incurs variable costs of \$2.47 per ton using railroad owned cars loaded to 116

tons in transporting coal from the Lee Ranch Mine to the Cholla Station

- ☐ This generates a revenue to variable cost ratio of 349%

V. COMPARISON OF RAIL RATE INCREASES IN RECENT CASES TO CHOLLA RAIL RATE INCREASE

As noted in the introduction to my statement, I was also asked by PEC to estimate the rail rate increases that were imposed by a rail carrier when that carrier implemented a common carrier tariff rate, in the case of four shippers who have recently challenged such rates before the Board. As part of this analysis, I also compare the increases experienced by these shippers with the rail rate increase imposed on the Lee Ranch to Cholla movement. I set forth below my methodology for this analysis, which relies on publicly available data, and present my findings.

A. Comparable Shipment Coal Rail Rate Estimating Methodology

The comparable shipment rate estimating methodology estimates the effective rail contract rates for certain coal movements in recent and pending STB cases, based on coal and rail rates derived from publicly available FERC data. This analysis uses FERC and Energy Information Administration (EIA) data on the delivered cost of coal per ton, and other publicly available data. To make the comparisons as meaningful as possible within the constraints of the data, we have relied on monthly rather than annual FERC and EIA data. The delivered cost of coal per ton includes the cost of the coal and the cost of coal transportation.

Based on the actual tariff rail rate that was effective upon expiration of a set of contracts and the contemporaneous FERC/EIA delivered cost data, I estimated the coal price by subtracting the actual tariff rail rate that was effective upon expiration of the contract from the delivered cost of coal per ton, as reported by FERC/EIA. As noted above, we calibrated to the month so that we minimized the time period between the effective dates of the FERC/EIA data and the tariff rail rate data.

The next step in the process assumes that the coal price remained unchanged from the previous month's result. We subtracted this derived coal price from the prior month's delivered cost data to estimate the rail contract rate. In this method we take the effective date of the tariff as the dividing line in time between contract rates and tariff rates. We then estimated the monthly percent increase in the estimated rail contract rate. In the final month in each series we estimated the percent increase from that final monthly estimated contract price to the observed rail tariff rate. This simple methodology enables us to compare the increase applied on comparable coal shipments. More specifically it provides a context within which to evaluate the rate increases applied to the Lee Ranch shipment by BNSF.

B. Coal Price and Rate Estimation Tables

The hypothetical example in the following table illustrates the method:

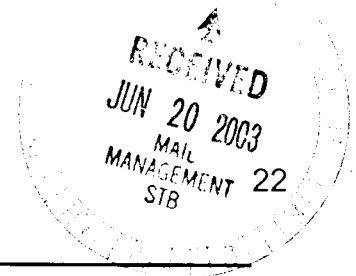
Coal Price and Rate Estimation Methodology				
Month and Year	Estimated Rail Contract Rate	FERC Delivered Cost per Ton	Rail Tariff Rate per Ton	Coal Cost Per Ton
Col1	Col 2	Col 3	Col 4	Col 5
	Col 3 minus Col 5	Source: FERC	Source: Rail Tariff	Col 3 minus Col 4 for year with observed tariff data ⁶
2002 Jan	N/A	\$25	\$14	\$11
2001 Dec	\$9	\$20	N/A	\$11

With this methodology we estimated the rail rate increase embedded in the FERC data. In the hypothetical example above, the observed January 2002 tariff rate of \$14 is 55% greater than the estimated December 2001 contract rate of \$9.

In applying this method we reviewed delivered coal prices computed on an annual and monthly basis. The monthly Federal Energy Regulation Commission (FERC) and Energy Information Administration (EIA) data affords the closest

⁶ The coal cost computed for the month with the observed tariff data is used as an assumed coal cost for the preceding 12 months. This is a reasonable assumption since

SK Snavely King Majoros O'Connor & Lee, Inc.



correspondence to the tariff rates. Using data specifying delivered coal prices on a monthly basis, I applied this rate estimating methodology to the following movements. The involved utility, the tariff rate and the effective date of the tariff rate are shown for each comparable shipment coal movement:

1. TMPA's Gibbons Creek Station, \$19.09, effective 4/1/01
2. Xcel Energy's Pawnee Station, \$9.24 effective 1/1/01

As detailed below we also analyzed a fourth utility, Otter Tail Power's Big Stone Station, using public information filed in the Otter Tail Corporation's Form 10-K, Form 10-Q and other filings before the Securities and Exchange Commission for the quarterly period ended September 30, 2002.

C. Approach

For the two power plants noted above, TMPA and Xcel, we used a data based approach with a three-part methodology.

The first part of the methodology, shown in Table 1, estimated the coal cost by subtracting the publicly available rail tariff rate from the FERC delivered coal cost in that month.

coal supply contracts and coal contract prices are often in effect for multiple years.

Coal Price and Rate Estimation Methodology				
Table 1. Estimated Coal Cost per Ton				
Utility Station	Month and Year	FERC/EIA Delivered Cost per Ton ⁷	Rail Tariff Rate Per Ton ⁸	Estimated Coal Cost Per Ton
(a)	(b)	(c)	(d)	(e)
				= (c) – (d)
TMPA – Gibbons Creek Station	Apr 2001	22.92	19.09	3.83
Xcel Energy's Pawnee Station	Jan 2001	15.85	9.24	6.61

⁷ Monthly Plan Aggregates: U.S. Electric Utility Receipts, Cost, and Quality of Fossil Fuels – Source Energy Information Administration, For EIA 906 Power Plant Report – month/year rates are average per station per short ton of delivered coal

⁸ Public Tariffs rates per short ton of coal provide by Counsel

The second part of the methodology, shown in Table 2, estimated the contract rail rate by subtracting the estimated coal cost from the FERC delivered coal cost in each month analyzed.

Coal Price and Rate Estimation Methodology				
Table 2. Estimated Rail Contract Rate				
Utility Station	Month and Year	Estimated Rail Contract Rate	FERC Delivered Cost per Ton ⁹	Coal Cost Per Ton ¹⁰
(a)	(b)	(c)	(d)	(e)
		= (d) – (e)		
TMPA – Gibbons Creek Station	March 2001	18.32	22.15	3.83
Xcel Energy's Pawnee Station	Dec 2000	7.90	14.51	6.61

⁹ Monthly Plan Aggregates: U.S. Electric Utility Receipts, Cost, and Quality of Fossil Fuels – Source Energy Information Administration, For EIA 906 Power Plant Report – month/year rates are average per station per short ton of delivered coal

¹⁰ Estimated Coal Cost Per Short Ton from Table 1. Estimated Coal Cost Per Ton

The third part of the methodology, shown in Table 3, estimated the increase in the tariff rate over the previous contract rate as follows (includes steps shown in Tables 1 and 2, above):

1. FERC delivered cost per short ton of coal was determined from the DOE/EIA-0226 Electric Power Monthly Report¹¹
2. Counsel provided rail Tariff Rate rates for coal transportation to a set of utility power plants. The FERC data was matched to the tariff month and year using Electric Power Monthly data sorted by month and year.
3. Estimated cost of coal was calculated by taking the difference between the total Delivered Cost of Coal and the Rail Tariff rate for coal for the same month.
4. FERC Delivered cost per short ton of coal was determined for the 12 prior months using the DOE/EIA-0226 Electric Power Monthly Report
5. The prior year rail cost was estimated by subtracting the cost of coal in the tariff month and year from the FERC delivered cost per short ton of coal in each of the 12 preceding months
6. Finally the estimated rail rate increase was calculated by subtracting the estimated rail rate in each of the 12 preceding months from the following month's estimated rail rate and finally from the rail rate provided by counsel for the month and year in which the tariff became effective. The estimated rail rate increase amount was then computed as a percentage rate change.

¹¹ Monthly Plan Aggregates: U.S. Electric Utility Receipts, Cost, and Quality of Fossil Fuels – Source Energy Information Administration, For EIA 906 Power Plant Report – month/year rates are average per station per short ton of delivered coal

Coal Price and Rate Estimation Methodology				
Table 3. Estimated Increase In Rail Rates				
Utility Station	Month and Year Range	Rail Tariff Rate Per Ton ¹²	Estimated Rail Contract Rate of Prior Year Based on FERC Data ¹³	Estimated Annual Increase in Rail Rate
(a)	(b)	(c)	(d)	(e)
				= (c) / (d) - 1
TMPA – Gibbons Creek Station	March 2001 -Apr 2001	19.09	18.32	4.20%
Xcel Energy's Pawnee Station	Dec 2000 – Jan 2001	9.24	7.90	17.00%

¹² Public Tariffs rates per short ton of coal provide by Counsel

¹³ Estimated Rail Contract Rate from Table 2, Estimated Rail Contract Rate

D. Otter Tail Plant Coal Supply and Rail Transportation Rates

We evaluated the Otter Tail Plant based on public documents filed by Otter Tail Corporation with the Securities and Exchange Commission (SEC). As stated by Otter Tail Corporation in its Form 10-Q Quarterly Report to the SEC for the quarter ended September 30, 2002:

"...during the three months ended September 30, 2002 compared with the three months ended September 30, 2001, production fuel expense increased \$0.4 million (3.4%) **as a result of a 15.9% increase in fuel costs per mwh produced. The increase in fuel costs per mwh produced reflects the new coal contract at the Big Stone Plant that went into effect at the beginning of 2002 and increased freight rates for the shipping of coal to Big Stone and Hoot Lake Plants.**"¹⁴ [emphasis added]

From other public documents filed with the SEC by Otter Tail Corporation we know that the new coal contract was a Coal Supply Agreement by and between Otter Tail Power Company, Northwestern Public Service, Montana-Dakota Utilities Co. and Rag Coal West, Inc.¹⁵

The SEC filings indicate that the new coal supply agreement was in effect as of September 28, 2001; with monthly delivered coal commitments. The coal supply

¹⁴ Source: Form 10 Q for quarter ended 9/30/02 filed with SEC by Otter Tail Corporation, page 18

¹⁵ Source: Exhibit 10 b filed with SEC by Otter Tail Corporation.

agreement referenced the BNSF as the provider of the coal transportation.

These SEC filings serve the same purpose as the methodology we have applied with the FERC data. They show the level of coal delivered costs for the Otter Tail plant. Moreover, the SEC filings show the increase in delivered coal cost with precision.

Whereas we have estimated the coal rate increase, the SEC filings report the combined effect of transportation rates and coal cost as increasing by 15.9% during the 12 months ended September 2002. Other information filed by Otter Tail indicates that the coal rates and the rail rates both increased.

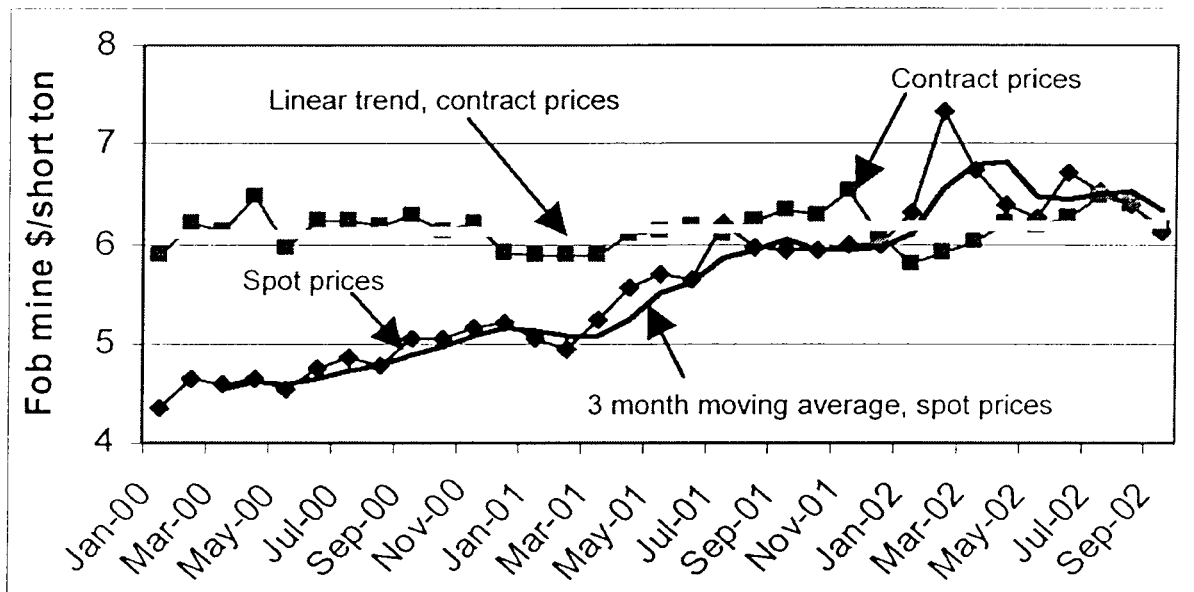
The Otter Tail Corporation Form 10-Q Quarterly Report to the SEC for the quarter ended September 30, 2002 states that in the nine months ended September 30, 2002 Otter Tail Corporation experienced a 13.5% increase in fuel costs per mwh produced due to "...**higher costs reflected in the new coal contracts ...and increased freight rates for the shipping of coal to Big Stone and Hoot Lake plants.**"¹⁶ [emphasis added]

E. Rate Increase Findings

Based on the findings from our analyses of FERC and EIA data, and the SEC reports, I conclude that the rail rates to the four plants, including Otter Tail, increased far less than the rate increase BNSF applied to the Lee Ranch To Cholla shipment.

F. Powder River Basin Coal Prices

Powder River Basin Prices



Source: Platts COALdat database; Platts is a division of The McGraw-Hill Companies, Inc.

We validated our methodology by comparing our results to data secured from two independent sources:

- ☐ The Energy Information Administration, a public government agency within the Department of Energy

¹⁶ Source: Form 10 Q for quarter ended 9/30/02 filed with SEC by Otter Tail , p. 21

-
- ☐ Coal and Energy Report; a private commercial publication

For example, we established that Powder River Basin coal contract prices were reasonably stable during the 1999-2002 period, as shown in the following data secured from The Energy Information Administration.

The Energy Information Administration within the US Department of Energy publishes coal contract prices in its Annual Coal Report and similar publications. The EIA data demonstrates the relative stability of Powder River Basin coal prices. EIA states:

“Western contract prices are holding more or less steady. For example, in the period January 2000 to September 2002, Powder River Basin contract prices increased from \$5.88 to \$6.15 per short ton....”¹⁷

The results of our analysis also comport with the coal costs readily available in publications such as Coal and Energy Report. Recent issues of this publication cite Powder River Basin coal prices in ranges comparable to those we derived through our estimating method.

As shown in the preceding chart, according to publicly available data from the Energy Information Administration and Platts CoalDat database, the Average

Monthly U.S. Coal Prices for Powder River Basin rates and Western contract prices “hold more or less steady”.¹⁸ For example for rates in January 2000 and January 2001, Powder River Basin Contract Prices remained approximately equal at 5.88. This supports our use of the preceding year stable coal cost assumption as shown in Table 2, Estimated Rail Contract Rate. This is part of our methodology for estimating rail rate change based on the FERC data.

¹⁷ Source: EIA, US Coal Prices – Illinois, Powder River and Uinta Basins.

¹⁸ U.S. Coal Prices www.eia.doe.gov 6/11/2003

VI. APPENDICES

A. Resume

Experience

Snavely King Majoros O'Connor & Lee, Inc., Washington, DC

- **Vice President (1988-Present)**

Mr. O'Connor has more than twenty-five years experience in business and economic analysis. His experience includes key and increasingly responsible management and policy positions with government agencies and private industry.

Mr. O'Connor has authored a series of guidelines on transportation negotiations and contracting and has conducted transportation negotiations and contracting seminars for a wide range of clients. Mr. O'Connor has also designed and helped lead transportation contract negotiations resulting in tens of millions in cost savings.

Mr. O'Connor has also appeared as an expert witness in successful coal rate litigation, achieving millions of dollars in savings for the client.

He has also created and managed numerous computerized management and regulatory systems to address complex problems and is a widely recognized expert on costing and economics.

He has conducted analyses of tug and barge operations, both inland and off shore, for private sector clients.

Mr. O'Connor has conducted analyses for the Government of Canada used to shape policy for freight transportation and studies for the U.S. Government used to shape Freight and Passenger Transport Policy.

For the Government of Bulgaria, in the Balkans, he developed the Master Plan for Management Information Systems, including telecom and computer facilities designed to operate, measure, manage and monitor both rail freight and rail passenger operations of the Bulgarian State Railways, in Bulgaria and the Balkan Peninsula.

Mr. O'Connor has analyzed more than 45 rail merger scenarios and cases. He has provided expert testimony before state and federal courts and commissions in the U.S. and Canada on economic and policy issues. He has also testified as an expert on computerized transportation analytical systems, rail operations, anti trust issues and transportation economics and costing. Mr. O'Connor has served as an impartial and expert monitor of data and processes at issue in litigation on transportation.

Mr. O'Connor has also conducted management audits, focused on identifying the cause and effect relationships underlying claimed cost incidence. The management audits were directed toward testing the cost basis of claims asserted by major railroads.

His experience in telecoms spans the period since 1995. During this period, on a succession of government and commercial projects, Mr. O'Connor directed and participated in the review, design and operation of telecoms systems.

He also designed and developed the business and operations plan for an Eastern European telecoms startup company, BDZCOM. Mr. O'Connor designed and presented the plan and conducted liaison with international commercial, banking and government interests in the United States and Europe.

DNS Associates Inc., Washington, DC

- **Vice President (1982 - 1988)**

Mr. O'Connor directed and participated in numerous projects including merger analyses, transportation infrastructure analyses, plant and network rationalization and feasibility studies.

He designed and implemented mainframe and microcomputerized systems for analyzing rail, truck and barge logistics. The computerized cost systems Mr. O'Connor created are in widespread use throughout the United States and Canada.

Mr. O'Connor also advised the U.S. Rail Accounting Principles Board on the costing aspects of regulatory reform policies.

He provided expert testimony on coal rates, computerized data bases and cost systems and rail cost issues before the Interstate Commerce Commission.

Association of American Railroads, Washington, DC

- **Assistant Vice President, Economics (1979 - 1982)**

Managing a large staff of professionals, Mr. O'Connor designed and managed major economic analysis projects. He helped formulate industry economic policy positions culminating in the Staggers Rail Act of 1980. He submitted expert testimony on behalf of the railroad industry in numerous cases before the Interstate Commerce Commission and state regulatory commissions. He also appeared regularly in national forums on economic issues.

Mr. O'Connor directed the most significant computerized industry Costing System project in 40 years, URCS, the cost system now used by all major US railroads. He also conducted industry seminars on URCS and related economic issues.

Mr. O'Connor also testified before the Interstate Commerce Commission on the design and application of this pathbreaking rail cost system since adopted by the Commission and the rail industry.

He also directed development and installation of a commercial computerized economic and market analysis system now used by virtually all major US railroads.

Consolidated Rail Corporation, PA

- **Assistant Director, Cost & Economics (1977 - 1979)**

Managing a staff of about 30 professionals, Mr. O'Connor was responsible for all Conrail management and regulatory cost analyses in both freight and passenger areas. He testified before the ICC on the development of subsidy standards now widely used in the US railroad industry.

He also finalized the design, installed and managed Contribution Simulator and Calculator (COSAC), a computerized internal management economic analysis system at Conrail. The COSAC system uses specific management accounting data to develop economic costs. COSAC replaced earlier systems and was used to guide virtually all transportation management decisions, including line abandonments and service discontinuance.

Mr. O'Connor also participated in cost allocation negotiations between Amtrak and Conrail on cost sharing of joint facilities on the North East corridor. He initiated and directed profit maximization and plant rationalization programs. He also designed and implemented computerization and improvement of a wide range of economic and cost analysis systems used to manage and turn around this multi-billion dollar corporation.

R.L. Banks & Associates Inc., Washington, DC

- **Consultant (1976 - 1977)**

Mr. O'Connor conducted and directed numerous transportation- related projects in the U.S. and Canada ranging from national logistics analyses to site-specific studies. He specialized in costing systems and appeared as an expert witness on such systems in a precedent setting proceeding before a Canadian Crown Commission.

U.S. Railway Association, Washington, DC

- **Manager, Local Rail Service Planning (1974 - 1976)**

In a project of unprecedented scope and historic implications, Mr. O'Connor developed, computerized, and implemented the light density lines cost analysis system, which defined Conrail. This system was used to reach line service decisions for thousands of miles of track. He served as liaison with congressional staffs and shipper groups, as well as federal, state, and local governments, and planning agencies. The system he created was a major element in the design and implementation of the streamlined Midwest-Northeast regional rail system. Mr. O'Connor subsequently appeared as an expert witness to present and defend the operation of the USRA costing system.

Interstate Commerce Commission,

- **Economist, Washington, DC (1973-1974)**

Mr. O'Connor served as a staff economist and authored a report analyzing industry investment patterns and ICC regulatory policy, including ICC use of cost evidence.

Education

- University of Massachusetts, Amherst, B.A. Economics
- University of Wisconsin, Graduate Course Work, Economics
- University of Delaware, Graduate Course Work, Business Management
- The American University, Graduate Course Work, Computer Science

Professional Organizations

- Transportation Research Board
 - Past Chairman of the Transportation Regulation Committee
- Transportation Research Forum
 - Past President of the Cost Analysis Chapter
- National Defense Transportation Association
 - Past Member of Board of Directors, National Capital Chapter

Academic honors

- Phi Kappa Phi academic honors society
- Phi Beta Kappa academic honors society

Military

- U.S. Army; Sergeant, Combat Engineers

Security Clearance

- Secret

B. Summary of Expert Testimony

My name is Tom O'Connor. I am Vice-President of Snavely King Majoros O'Connor & Lee (Snavely King), an economic and management consulting company. I have been engaged in the business of economic analysis for more than twenty-five years, beginning in 1973 as an economist with the Interstate Commerce Commission (now the Surface Transportation Board) and later in economic consulting and management positions of increasing responsibility with the United States Railway Association, Conrail, the Association of American Railroads and, from 1982 through 1988 with DNS, Associates and since 1988 with Snavely King Majoros O'Connor & Lee, (Snavely King), an economic and management consulting company focusing on telecommunications and transportation. I was Vice President at DNS Associates and have been Vice President and principal of Snavely King since joining the firm in 1988.

I have provided testimony in a number of proceedings before courts and regulatory commissions in the United States and Canada including:

- ☐ Interstate Commerce Commission,
 - ☐ Surface Transportation Board,
 - ☐ United States Railway Association,
 - ☐ Regulatory Commissions in Indiana, New York, and Pennsylvania,
 - ☐ State Courts in Montana and Virginia,
 - ☐ Arbitration Panel in New York
 - ☐ Mediation Panel in Massachusetts
-

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- ☐ Canadian Crown Commission.
 - ☐ US District Court for Eastern District of Virginia,
 - ☐ US District Court for Arizona

Tom O'Connor Testimony in Federal Regulatory Cases

- **The comparative merits of the Interstate Commerce Commission's Uniform Rail Costing System (URCS) and Cost Center Accounting** submitted to the ICC on behalf of the US Railroad industry in February 1980 in Docket No. 37203.
- **The economics and computer technology of the Light Density Line Methodology used to define Conrail**, submitted to USRA before a special hearing in 1980.
- **Computerized transportation database design and use.** Verified statement was submitted to ICC on behalf of the US Railroad industry in Nov 1980 in Ex Parte No. 385.
- **The comparative merits of two regulatory rail-costing systems, URCS and Rail Form A**, submitted to the ICC on behalf of the US Railroad industry in March 1981, in Ex Parte 399.
- **Testimony on the Preliminary 1979 Rail Cost Study as released by the ICC, calling for adopting and improving URCS.** This was

submitted to the ICC on behalf of the US Railroad industry in Docket No. 37203 in February 1982.

- **Rail costing using Rail Form a costs applied to service units generated by a computerized rail network model.** This verified statement was submitted to the ICC on behalf of a shipper located in Nevada in July 1985 in ICC Docket Nos. 37809 and 37815S.
- **Rail costing, also using Rail Form A costs applied to service units generated by computerized network model.** This verified statement was submitted to ICC on behalf of a shipper located in Nevada in November, 1986 in Docket No. 37809, 37815S.
- **Stand Alone Rail Costing, for use in rate reasonableness, using service units developed with a series of computerized network model.** This verified statement was submitted to the ICC on behalf of the Association of American Railroads in September, 1988 in Docket No. 38239S
- **Rail merger conditions, developed using rail costs and a computerized network model.** This verified statement was submitted to the ICC in March 1994 in Finance Docket No. 21215 (Sub. No. 5)
- **The effects of computerized methods on rail operations and**

costs. This verified statement was submitted to the ICC on behalf of Coletto Creek Utility in July 1994 in Docket No. 41242.

- **The cost of rail coal transportation using URCS costs and A Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in April 1995 in Docket No. 41191.
 - **Further testimony on the cost of rail coal transportation using URCS costs and a Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in July 1995 in Docket No. 41191.
 - **Oral Argument on the effects of the BN-SF merger on rail costs and service presented before the full Commission** in August, 1995 on behalf of Universal Forest Products in Finance Docket No. 32549.
 - **The effects of the UP-SP merger on costs, infrastructure and operations.** Verified statement was submitted to ICC on Behalf of Kansas City Southern Railroad in March 1996 in Finance Docket No. 32760.
 - **Competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJ MAXX on June 22, 1998 in Docket No. 41192
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- **The investment plans of UP-SP to remedy effects of the UP-SP merger.** Verified statement was submitted to STB on Behalf of Kansas City Southern Railroad in June, 1998 in Finance Docket No. 32760 UP-SP Merger Oversight Proceeding
 - **The Arkansas and Missouri Railroad Request For Discontinuance Waiver** Filed on Behalf of Kansas City Southern Railroad. Verified statement was submitted to Surface Transportation Board (STB) in November 1998 in Finance Docket No. 32670.
 - **Further testimony on the competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJMAXX in January, 1999 in Docket No. 41192
 - **Rail Merger Guidelines to develop new and improved merger analysis processes.** Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in May 2000 in Ex Parte 582.
 - **Reply Testimony on Rail Merger Guidelines to develop new and improved merger analysis processes.** Reply Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in June
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2000 in Ex Parte 582.

Tom O'Connor -- State, Regional and Canadian Testimony

- **Expert testimony centering on truck transportation and the implications of transportation in an anti-trust case.** This testimony involved development and analysis of data on shipments of lime from a number of locations into Phoenix and the surrounding area. This evidence was developed and submitted on behalf of Solcon in May 2003. The case is now under adjudication in US District Court for Arizona.
- **Expert testimony centering on commuter railroad operations and costs.** This testimony involved design and development of computerized costing models of commuter rail operations. The evidence was central to arbitration to resolve subsidy disputes between New York and Connecticut. This evidence was developed and submitted on behalf of Metro North Commuter Railroad in August 1996 with oral testimony presented in February 1997. The case was decided successfully in favor of the client.
- **Expert testimony centering on the effects of a series of explosions on transportation operations and costs.** This was submitted on behalf of Washington construction Company in a damages case filed by Burlington Northern Railroad in state court

in Montana, First Judicial District Court, and Cause Number ADV 91-1885. The case went to a jury trial and was decided successfully in favor of the client in September 1993.

- **Expert testimony centering on computerized network models.**
This was submitted in an antitrust case filed on behalf of Geoplex in U.S. District Court for the Eastern District of Virginia, Geoplex Corporation v. CACI, Inc. Civil Action No. 89-610-A. This evidence was developed and submitted in November 1989.
- **Expert testimony centering on transportation operations and costs.** This was submitted on behalf of the Canadian provinces of Alberta, Manitoba and Saskatchewan before a Canadian Crown Commission in a series of hearings held in Winnipeg, Manitoba and Regina, Saskatchewan in 1976. This led to an historic change in Canadian transportation regulation.
- In addition to these cases Mr. O'Connor has also submitted testimony on rail costs and operations before State regulatory commissions in Indiana, Pennsylvania and New York.

Cost Exhibits

(All Exhibits TOC_1, 2, and 3 are in electronic form on enclosed CD-ROM)

SK Snavelly King Majoros O'Connor & Lee, Inc.

VII. VERIFICATION

I, Tom O'Connor, declare that the foregoing statement is true and correct and was prepared by me or at my direction. Further, I certify that I am qualified and authorized to file this statement.

Executed on June 13, 2003.

Tom O'Connor

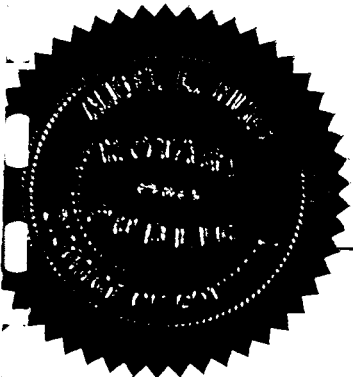
Tom O'Connor

Subscribed and sworn to before me this 13th day of June 2003 in the District of Columbia.

Angel L. Ferick

Notary Public

My Commission expires: March 14, 2006

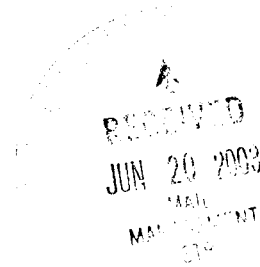


Verified Statement of Tom O'Connor • Docket No. 42077

June 20, 2003

By Messenger

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423-0001



RE: Docket No. 42077, *Arizona Public Service Company and PacifiCorp v. The Burlington Northern and Santa Fe Railway Company*

Dear Secretary Williams:

On June 16, 2003, Peabody Energy Corporation filed a "Petition for Injunctive Relief" in the above-referenced docket. Since that date, Peabody has become aware of a discrepancy between the signed "Original" version of that pleading and the ten copies that were filed with the Board. The discrepancies occur entirely within Exhibit 2, the Verified Statement of Tom O'Connor, on pages 22-26. We have enclosed replacement pages to correct this discrepancy. These replacement pages DO NOT contain "Highly Confidential" information, and thus may be substituted in both the "Public" and "Highly Confidential" versions of the pleading.

This discrepancy exists only in the "Original," or official version. All of the copies filed with the Board and served upon the parties are correct as filed and served.

Sincerely,

Jeffrey O. Moreno

Enclosures

cc: (with enclosures)
Samuel M. Sipe, Esq.
Michael H. Loftus, Esq.