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April 12, 2004

Via HAND DELIVERY

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

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

Dear Secretary Williams:

Enclosed for filing in the above-captioned matter are the original and fifteen copies of the Post-Argument Reply Brief of Defendant The Burlington Northern and Santa Fe Railway Company. Also enclosed are three diskettes containing the electronic version of this filing.

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

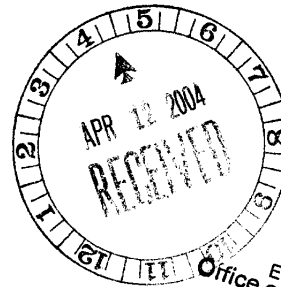
Sincerely,



Anthony J. LaRocca

Enclosures

cc: Counsel for Complainant



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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

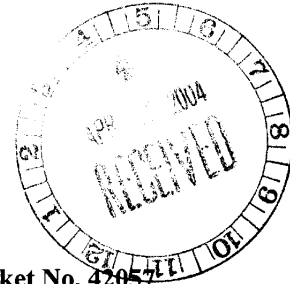
**PUBLIC SERVICE COMPANY OF
COLORADO d/b/a XCEL ENERGY,**

Complainant,

v.

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

Defendant.



Docket No. 42057

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

On April 5, 2004, both parties in this case filed post-argument briefs in response to a Board order served March 18, 2004. This is the Reply Brief of Defendant The Burlington Northern and Santa Fe Railway Company ("BNSF") to the Post-Argument Brief of Complainant Public Service Company of Colorado d/b/a Xcel Energy ("Xcel").

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

BNSF explained in its Post-Argument Brief why the scope of any disconnect in this case between the operating plan and traffic group selected by the Board should be relatively limited. Under the best evidence rule, the Board should reject Xcel's operating plan and adopt the operating plan presented by BNSF as the only operating plan in this case that provides for feasible SARR operations. Rejection of Xcel's operating plan will necessarily resolve in BNSF's favor the most significant traffic issue in the case -- *i.e.*, whether the rerouted Jeffrey traffic can be included in the SAC analysis. The remaining traffic issues are not as significant as the Jeffrey issue but they would not necessarily be resolved if the Board rejects Xcel's operating plan and accepts the BNSF operating plan. As BNSF explained, legal and practical

considerations indicate that the Board should look to the parties to supplement the record if the Board concludes that the record does not contain adequate evidence to support a decision. BNSF noted that this is the approach taken by the Board in other recent cases.

Xcel's array of suggestions in its Post-Argument Brief about the tasks the Board might need to undertake to remedy any perceived deficiencies in the record demonstrates that, as a practical matter, it would be profoundly difficult for the Board to generate reliable and accurate record evidence to modify an operating plan to reflect a traffic group other than that posited by the party sponsoring the operating plan. Moreover, the Board sought the parties' views on how adjustments might be made to an operating plan "based on the existing record,"¹ but Xcel's Post-Argument Brief makes it clear that the existing record does not contain evidence necessary to assess the impact of adding new traffic to an existing operating plan.

Xcel devotes several pages of its brief to the proposition that the Board could use the flawed string program as the starting point in any attempt to produce a new operating plan and capacity assessment for the SARR. Xcel blithely suggests that the Board can produce a new operating plan simply by changing certain inputs line-by-line in various files within the string program. This suggestion is clearly misplaced.

First, the only circumstance under which the Board would even have a reason to consider manipulating the string program is if it accepted Xcel's operating plan. But BNSF's operating plan is clearly superior to Xcel's.

Second, the string program that Xcel used in its rebuttal evidence in this case is seriously flawed, as Xcel itself admits, as it ignores grades and curves. Xcel filed an errata to its rebuttal

¹ See Issue 1 in the Board's Order directing filing of post-argument briefs, *Public Service Co. of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Railway Co.*, STB Docket No. 42057 (served Mar. 18, 2004).

evidence on June 23, 2003, in which it claimed that this flaw could be corrected with a modification to the program code, but there is no way to know based on this record how the purported correction affects the string program operation or output, whether the purported correction actually remedies the flaw or whether the purported correction creates other problems in the operation or output of the string program. Indeed, the history of Xcel's own attempts to use the string program in this case demonstrates that each time Xcel used the string program it produced erroneous results and each time Xcel modified the string program in an effort to correct those errors it either failed to correct the errors or introduced new ones. BNSF's pleadings in this case lay out the multiple errors with each successive version of the string program evidence submitted by Xcel.² Moreover, pervasive, unremedied problems in the string program persist, such as the failure of the string program to model continuously cycling unit trains.

Third, even if the string program were not fatally flawed, the process of generating a modified string program analysis would be complicated and fraught with the risk of error. The lengthy list of program files that Xcel discusses (which would only be the starting point for any attempt to redo the string program analysis) illustrates the complexity of the proposed effort.³ There is no reason to believe that the Board, or anyone else, would be able to produce reliable and accurate output from the string program when Xcel itself is unable to do so.

² See BNSF Motion for Leave to File Limited Surrebuttal at 5-8 (filed June 6, 2003); BNSF Surrebuttal Verified Statement of Karl M. Leopold and Terence J. Monks at 13-20 (filed June 6, 2003); BNSF Reply Nar. at III.B-15 to 20 and III.B-35 to 37 (filed April 4, 2003); BNSF Motion for Summary Disposition and Stay at 14-18 (filed Feb. 6, 2003).

³ Xcel's suggestions about changes that might need to be made to some program files are unclear. For example, Xcel discusses the possibility of changing the SARR destination for particular shippers. See Post-Argument Brief at 6. This suggestion would seem to apply only where the Board concluded that a rerouted movement should be required to follow the real world route of movement. The only rerouted movement in Xcel's SARR is the Jeffrey movement, and the real world route of the Jeffrey trains follows the SARR only to Donkey Creek.

Finally, Xcel fails to mention that the string program does not actually test for capacity. As Xcel's consultants admitted at the March 12, 2004, string program demonstration held in this case, manual inspection of the string program output is required to determine whether yards and sidings are overloaded and then additional manual "adjustments" must be made to train operations to avoid collisions. It would be improper for the Board, as the decisionmaker in this case, to remedy the deficiencies in Xcel's evidence by making the numerous judgments that would be required to perform these manual adjustments. Moreover, it would not be prudent as a practical matter for the Board to perform these manual adjustments given the difficulty of this task and the potential for error, as demonstrated by the numerous errors that Xcel itself makes when it attempts to make manual adjustments.

Xcel also addresses the possibility that the Board will accept BNSF's operating plan based on the RTC model and discusses adjustments that might be made to operating statistics and capacity requirements. As to operating statistics, Xcel suggests, but does not explain in detail, that it would be possible for the Board to generate new operating statistics without rerunning the RTC model by simply manipulating various spreadsheets submitted by BNSF. As BNSF noted in its Post-Argument Brief, the Board has made adjustments to operating costs in past cases to account for relatively small changes in traffic volumes. However, if the Board changes the traffic group that BNSF used in developing an operating plan, it would also be necessary to assess whether the SARR's track configuration is capable of handling increases in traffic volume. This undertaking is far more complex.

BNSF used the RTC model to assess SARR capacity but Xcel does not even address the possibility that the Board might use the RTC model to assess the capacity requirements of a SARR that handled additional traffic. Instead, Xcel proposes an entirely new method for

evaluating capacity based on a formula that is not even in the record of this case. There are three fatal problems with Xcel's proposal.

First, it is too late in the process for Xcel to be proposing a new method for evaluating capacity requirements, particularly where BNSF has no opportunity to present any responsive evidence. Indeed, Xcel's proposal is at odds with the Board's request for comments on how adjustments might be made based on evidence already in the record.

Second, the use of a formulaic approach to assessing capacity would not be appropriate in this case. Generic capacity formulae, even when they are applied properly, provide at best a rough approximation of capacity requirements. Indeed, neither party in this case assumed that the assessment of capacity could or should be based on the broad and imprecise assumptions used in a formula for supposed theoretical capacity. A critical input to the SAC analysis involving a high-density coal railroad is the amount of capacity that the railroad would need, and this issue is especially important where adequate capacity is required to ensure that shippers receive service at least as good as the incumbent's service. Capacity formulae are incapable of assessing the adequacy of capacity in light of service requirements. Therefore, reliance on rough estimates of capacity produced by a capacity formula would not be appropriate and could not constitute the best evidence of SARR capacity where a more refined method for testing capacity as the RTC model is in the record. The RTC model assesses capacity in light of real world operations, and use of the RTC model is clearly the superior means of testing the capacity of a SARR.

Third, the formula presented by Xcel is highly sensitive to assumptions such as transit times. But the assumptions Xcel has used in presenting its new capacity analysis are clearly unreasonable. For example, Xcel assumes that all trains operate at the maximum possible speed

and require only a nominal amount of additional time for acceleration and deceleration. (Xcel claims that it assumes five minutes per train for acceleration and deceleration, but its calculations actually reflect only half that amount of time for each train.) These assumptions are unrealistic and dramatically understate transit time.

Xcel's new approach to yard capacity suffers from the same flaws. The new approach involves a simple calculation showing how many trains could occupy each yard based on the number of tracks in the yard and the time that each train must spend in the yard. As with Xcel's mainline capacity formula, this approach calculates yard capacity assuming, unrealistically, that train arrivals and departures are evenly spaced and that each yard track is occupied 24 hours per day. Because the SARR traffic group consists of unscheduled coal trains, its yards must contain additional capacity to accommodate coal trains arriving in bunches and to allow for staging into mines that have limited capacity. *See* BNSF Reply Nar. at III.B-37 to 42. The Board could not properly base an alternative capacity assessment of the SARR yards on a formulaic approach that ignores real world operating conditions in the PRB.

For the reasons stated above and in BNSF's Post-Argument Brief, the Board should seek additional evidence from the parties if it determines that the record does not contain adequate evidence to support a decision.

II. THERE IS NO BASIS FOR CONSIDERING ALTERNATIVES TO THE RCAF-U AND RCAF-A IN THIS CASE

The record in this case frames the issue of operating cost inflation for the SARR as a choice between two indices, the RCAF-U and the RCAF-A. As BNSF explained in its Post-Argument Brief, the Board's consideration of the operating cost inflation issue in this case is limited to those two alternatives and as between those two indices, the RCAF-U is clearly superior. Xcel's Post-Argument Brief acknowledges that the real issue in this case is whether to

use the RCAF-U or the RCAF-A, but it inconsistently suggests that the Board should also consider other alternatives. Xcel's Post-Argument Brief presents no valid reason to consider other alternatives.

Xcel's claim of future operating cost productivity rests on a faulty premise. Xcel argues that some type of productivity adjustment is necessary to account for productivity gains that the SARR will experience over the 20-year DCF period. According to Xcel, "[c]hief among these productivity gains is the fact that while all of the capital investment for the WCC will be made prior to the base year 2001, the traffic density over the railroad will increase a substantial 26% over the DCF period." Xcel Post-Argument Brief at 15. But as discussed below, increases in traffic density do not generate productivity improvements in most operating costs as calculated for the SARR.⁴ Moreover, where increases in density do create productivity gains in operating costs for the SARR, the Board's DCF already takes into account those productivity improvements.

Most SAC operating costs are unrelated to density. Crew, locomotive ownership and locomotive operating costs make up the majority of SAC operating costs. But the number of train crew members, the number of locomotives, and the amount of locomotive operating costs are directly related to the number of trains operating on the SARR, not to the density of traffic on SARR lines. For example, two crew members are required to operate each train, so each train that must be added to the SARR as traffic volumes increase requires exactly two additional crew members, whether the new train is added at the beginning of the 20-year DCF or at the end of the period and regardless of the density of the SARR lines when the new train is added. Thus, there

⁴ BNSF acknowledges that increases in density result in more efficient use of fixed plant.

is no reason to believe that increases in density produce declining unit costs for the majority of SAC operating expenses.

Some SAC operating costs such as G&A and MOW are not tied directly to the number of trains operating on the SARR. But the Board's DCF already reflects productivity improvements in these costs that might result from increases in traffic density. In the Board's DCF model, G&A and MOW expenses do not increase with increases in traffic volumes but rather are kept constant over the DCF period. Thus, as traffic volume increases, G&A and MOW costs decline on a per-ton basis. These productivity gains are already included in the DCF analysis since traffic increases are not accompanied by corresponding increases in G&A and MOW costs. Therefore, there is no reason to consider any additional productivity factor in the inflation index to account for these productivity gains.

Most of Xcel's Post-Argument Brief, however, is focused not on justifying the application of a productivity adjustment but rather on presenting two methodologies for "estimat[ing] the productivity of a coal-only SARR." Xcel Post-Argument Brief at 15. Xcel presents these methodologies in the first instance as a means to test the "appropriateness of using the RCAF-A in this case." *Id.* However, it is clear from the graphs Xcel presents at Attachment 3 and Attachment 5 that neither methodology supports the use of the RCAF-A. Both methodologies produce estimates of productivity improvements for the SARR that differ significantly from the RCAF-A.

While Xcel presents its two alternatives as support for its use of the RCAF-A, it also suggests that "either of the two methods could be used instead of the RCAF-A or RCAF-U." *Id.* But it is too late in this proceeding for the Board to consider new evidence on the proper index of operating cost inflation. Xcel has consistently advocated in this proceeding the use of the

RCAF-A, and it continues to advocate use of that index in its Post-Argument Brief. The two alternatives that Xcel identifies in its Post-Argument Brief were never identified or discussed in the evidentiary phase of this proceeding. The Board cannot expect to develop a full record at this stage of the case on the validity of new methodologies for assessing operating cost inflation. Both methodologies proposed by Xcel involve numerous assumptions, data tables and graphs but they are unaccompanied by supporting evidence or workpapers. BNSF does not have the opportunity in the context of this Post-Argument Reply Brief to evaluate the underlying calculations and assumptions and to prepare a thorough analysis of these methodologies.⁵

Nevertheless, it does not require an evidentiary response to show that both methodologies are conceptually flawed. Xcel's first alternative is to calculate a productivity factor for the SARR by comparing the SARR's projected operating costs (adjusted to reflect constant 2001 dollars) to the SARR's projected traffic volume on a rolling five-year basis. Using this comparison, Xcel purports to identify a productivity factor for the SARR that reflects the extent to which the SARR is assumed to provide its transportation service with declining operating costs per unit of traffic. But this convoluted methodology does nothing more than identify the amount of productivity that the Board's DCF already assumes that the SARR will achieve. As noted above, some operating costs, like G&A and MOW, do not increase as traffic volumes increase but rather are kept constant over the 20-year DCF period. Since total operating costs do not increase at the same rate as increases in traffic volume, the DCF already assumes that productivity will be achieved by the SARR -- *i.e.*, that its transportation service will be provided over time with declining operating costs per unit of traffic. Xcel's first methodology merely

⁵ BNSF is filing today an opposition to Xcel's petition for leave to file the attachments to its Post-Argument Brief that contain the data and calculations relating to its proposed alternative methodologies.

calculates a factor that reflects that productivity growth. Since that productivity factor is already included in the DCF calculations, it would be redundant to apply an additional productivity factor in forecasting operating cost inflation.

Xcel's second alternative methodology is also conceptually flawed. Xcel's second methodology purports to use what is characterized as a productivity factor embedded in the EIA's forecast of coal transportation rates as a substitute for the productivity factor used in the RCAF-A. However, there is no evidence in the record as to how the EIA calculates this factor. It is therefore impossible to determine whether the EIA's factor reflects developments in the market that would be irrelevant to the projection of operating cost inflation, such as changes in the mix of long- and short-haul coal traffic or changes in competitive conditions that affect rate levels. In any event, the use of an EIA forecast of future productivity would suffer from the same flaw as the use of a forecast of the RCAF-A -- both forecasts project future productivity based on the historical experience of existing railroads. The Board has already acknowledged that an estimate of future productivity improvements for existing railroads would substantially overstate any conceivable productivity improvements that could be expected from a new, hypothetically efficient railroad that enters the market with brand new assets and state of the art technology.⁶

As BNSF noted in its Post-Argument Brief, the Board is not precluded from accepting in a future case probative and reliable evidence that might support the use of an inflation index based on something other than the RCAF-U and RCAF-A. However, the proponent of such an alternative index must present evidence on the source of productivity improvements that a SARR could expect, as well as the time frame for such productivity improvements and the costs to

⁶ See *Carolina Power & Light Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42072, at 27-28 (served Dec. 23, 2003).

obtain them. The record in this case does not include such evidence. Xcel has presented no evidence in this case that would support a departure from the Board's consistent finding that the RCAF-U is the proper index to apply in a SAC case to estimate future operating cost inflation.

III. THERE IS NO BASIS FOR CONSIDERING AN ALTERNATIVE RATE REDUCTION METHOD ON THE RECORD OF THIS CASE

BNSF's Post-Argument brief demonstrated that there is no basis in Board precedent for even considering an alternative to the percentage rate reduction method under the facts of this case. Xcel's Post-Argument Brief does nothing to alter that conclusion.

Xcel's discussion of how the Board should calculate a maximum reasonable rate if it finds that revenues exceed SAC is characterized by multiple inconsistencies. First, Xcel states that a prerequisite to pursuing an alternative to the percentage reduction approach "is a finding by the Board that . . . manipulation has occurred." Xcel Post-Argument Brief at 22. Yet Xcel proceeds to offer an alternate method for computing the maximum reasonable rate that "does not require the Board to first determine that 'gaming' is present." *Id.* Xcel offers not a word of explanation as to the disappearance of the "prerequisite."

More fundamentally, Xcel is fatally inconsistent on the subject of demand-based differential pricing. Xcel acknowledges in its Post-Argument Brief that the *Guidelines* are based on the principle that rail rates should reflect the relative demand elasticity of individual shippers. Xcel Post-Argument Brief at 20. Xcel has previously acknowledged in this case that its demand for rail transportation on movements to its Pawnee plant is highly inelastic. Yet Xcel's claim of "manipulation" regarding BNSF's rates is based on the allegation that BNSF's rates on the Pawnee movement exceed "the average rate for the WCC's captive customers on a mill/ton mile

basis in 2001.” *Id.* at 21.⁷ Xcel implies that the goal of a Board rate prescription should be to reduce the Pawnee rate to the average level. Such a result would be a repudiation of differential pricing and would contradict the statutory revenue adequacy mandate.

Xcel’s claim that the mere charging of an above-average rate for service to the Pawnee plant is evidence of gaming is nonsense and is inconsistent with the demand-based pricing principle that Xcel itself acknowledges to be the foundation of the Board’s rate reasonableness standard. On the most elementary level, Xcel ignores the fact that an average rate is the product of a range of rates, some of which are higher than the average rate and others of which are lower than the average. Indeed, the only way a railroad could implement demand-based pricing, which Xcel concedes is appropriate under the *Guidelines*, would be to charge rates that vary based on the relative demand elasticity of individual shippers. Rates for shippers with more inelastic demand will necessarily be higher than the average rate. Since the uncontested evidence in this proceeding shows that Xcel’s demand for coal transportation to its Pawnee plant is highly inelastic, Xcel should be expected to pay rates that exceed the average. There is simply no evidence of gaming by BNSF in this case that would justify a departure from the percentage reduction methodology that the Board has used in prior cases.

Xcel suggests that the Board consider a “rate mark-up” approach to setting maximum reasonable rates that it claims “is more precise than the percent reduction method.” Xcel Post-Argument Brief at 22. The supposed precision apparently stems from inferring demand elasticities from the ratio of cross-over revenue to marginal costs for traffic in the stand-alone shipper group. Apart from the many technical issues with this approach that are beyond the

⁷ As BNSF explained in its Post-Argument Brief, Xcel could not plausibly argue that the modest increase in the common carrier rate after the expiration of the prior contract constitutes gaming of the type alleged in the recent eastern cases.

scope of this reply brief, there is no support for Xcel's claim of greater precision. Indeed, it would be inappropriate to consider reducing the excess of revenues over SAC in accordance with demand elasticities on individual movements unless the Board concluded that its calculated SAC represents a good approximation of the revenue needed and available from a proper selected shipper group at Ramsey prices. There is no evidence whatever on this record here that this could be the case. Indeed, where the SARR is dominated by cross-over traffic, it is not possible to determine the revenues that are needed to cover the costs of the facilities needed to serve the selected traffic because the costs of the facilities have not been identified and the cross-over revenue attributed to portions of movements cannot be a measure of real world demand on through movements.

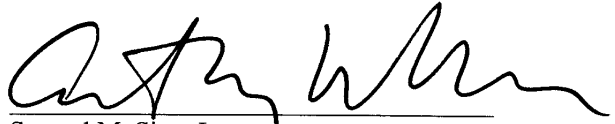
In the absence of an affirmative showing that SAC closely approximates the revenues needed to cover full costs under properly calculated Ramsey prices, the rate mark-up alternative runs the risk of turning demand-based pricing on its head. Under the rate mark-up alternative, the Board is urged to make larger rate *reductions* for shippers with the highest demand inelasticity. If SAC does not closely approximate Ramsey outcomes, such an approach could lead to a perverse denial of differential pricing, which involves the charging of *higher* rates to shippers with inelastic demand.

The Board's interest in exploring alternative rate prescription methodologies stemmed from a concern that the percent reduction methodology was susceptible to manipulation. But Xcel presents its rate mark-up alternative as an approach to be used in the absence of any finding of gaming or manipulation of standard SAC methodologies. Under those circumstances, there is no reason to consider a departure from the Board's standard percentage reduction approach. Moreover, it is too late for the Board to consider Xcel's rate mark-up approach in this case. An

enormous amount of data would need to be generated and evaluated in order to implement this approach. Xcel has not provided the data but rather suggests the Board could carry out the necessary calculations. It would be improper, however, for the Board to create new evidence without giving BNSF the opportunity to address it.

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Respectfully submitted,



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April 12, 2004

CERTIFICATE OF SERVICE

I hereby certify that on April 12, 2004, I caused a copy of the foregoing Post-Argument Reply Brief of Defendant The Burlington Northern and Santa Fe Railway Company to be served by hand upon the following counsel for Public Service Company of Colorado d/b/a Xcel Energy:

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