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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

AEP TEXAS NORTH COMPANY

Complainant,

v.

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY

Defendant.

Docket No. 41191 (Sub-No. 1)

**REBUTTAL EVIDENCE OF
COMPLAINANT AEP TEXAS NORTH COMPANY**

**NARRATIVE
VOLUME 2 OF 2**

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III-D Operating Expenses

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III. D. OPERATING EXPENSES

On Opening, AEP Texas determined the TNR's equipment, personnel and other operating statistics for the peak week of the peak traffic year (2020), and then applied a ratio to the 2020 operating units to derive the operating units for the base (first) year of operations (2000).¹ BNSF begins its Reply discussion of the TNR's annual operating expenses with an attack on the methodology used by AEP Texas Witness Thomas Crowley to reduce operating units from the peak year to the first year. BNSF then proceeds with a discussion of each element of annual operating expense following the Board's outline format for the presentation of SAC evidence.

AEP Texas has responded to BNSF's discussion of the development of operating units in the base year in Part III-C, *supra*, in connection with the TNR's locomotive requirements. *See* pp. III-C-9 to 23, *supra*. As described there, AEP Texas' Opening procedure involved developing and applying a peaking factor to determine the number of locomotives the TNR would have to lease on a short-term basis to meet its peak demand. *See* AEP Texas Op. at III-D-131.

Specifically, as described in Part III-C-1, *supra*, AEP Texas determined the aggregate number of trains that exceeded the average trains per day for the peak year on any given day. Stated differently, AEP Texas accumulated the number of trains greater

¹ The DCF model indexes annual operating expenses forward after the first year of SARR operations.

than the average number of trains on each day throughout the peak year. On Opening, this equaled 5.6 percent of the aggregate of the trains moving on days when the average or less than average number of trains are moving. AEP Texas then assumed that an additional 5.6 percent of the base locomotive units required in any given year would be acquired on a short term basis, either through a short-term lease such as the BNSF/First Union lease discussed above or from other connecting carriers, which have a temporary surplus of locomotive power.

Further, in order to recognize the fact that short-term lease rates are likely to be higher than long term lease rates, AEP Texas used an annualized daily lease rate for the lease payments associated with these “peak” locomotives. The daily lease rate was developed from lease rates provided by BNSF in discovery for SD70 locomotives.

AEP Texas’ procedure for developing operating units in the first year of the TNR’s operations (and for subsequent years) is logical and better supported than BNSF’s procedure, which is described in Part III-C-1, *supra*.

1. Locomotives

a. Leasing

BNSF has accepted AEP Texas’ approach of having the TNR lease all of its locomotives. BNSF also has accepted AEP Texas’ lease cost per unit for the TNR’s SD40-2 helper and switching locomotives. However, BNSF disagrees with AEP Texas’

development of lease costs per unit for its SD70MAC road locomotives. (The parties also disagree as to the number of locomotives needed by the TNR.)

On Opening (specifically, in the electronic workpapers accompanying AEP Texas' Second Errata filed on April 12, 2004), AEP Texas determined that the TNR would require 242 SD70MAC locomotives for unit coal train service and non-coal train service and 47 SD40-2 locomotives for helper service and switch service in the 2000 base year. On Reply, BNSF contends that operation of the TNR would necessitate 232 SD70MAC locomotives for coal unit train and non-coal train service and 55 SD40-2 locomotives for helper, switch and work train service in the 2000 base year.²

As shown in Part III-C-1, *supra*, part of the difference in locomotive requirements lies in each party's different traffic group, and calculations of cycle times and other operating assumptions, but much of the difference has to do with differences in the parties' spare margins and peaking factors. As discussed at pp. III-C-21 to 24, *supra*, AEP Texas uses a 5.0 percent locomotive spare margin, compared with BNSF's { } percent spare margin. Further, AEP Texas uses a 5.6 percent peaking factor to account for the additional locomotives required to handle traffic incremental to the average level of traffic on any given day. BNSF however, proposes that the TNR increase the number

² As discussed in Part III-C-1, *supra*, AEP Texas has added two SD40-2 locomotives in Rebuttal to account for work train service.

of locomotives in its fleet by 22 percent in order to have the ability to handle the trains moving on the peak day.

Had BNSF used the same spare margin as AEP Texas, without its excessive peaking factor, but retained all of its other operating assumptions, BNSF would have included only 196 SD70MACs locomotives in its Reply evidence. Put another way, BNSF's premise that 22 percent of TNR's locomotive fleet would be unused or unavailable at any given time results in an 18 percent difference between the parties regarding the number of SD70 locomotives.

On Opening, AEP Texas assumed an annual lease cost of { } for each SD70MAC locomotive required for the TNR's average or normal traffic demand, based upon a lease provided by BNSF in discovery. In addition, AEP Texas used an annualized daily lease rate of { } per locomotive, applied to the additional locomotives that are required to meet the peak period demand.³

³ On Reply, BNSF appears to dispute AEP Texas' development of an annualized daily lease rate but its reasoning is unclear:

It is unclear why AEP Texas chose to apply a "daily lease expense," which it mischaracterizes as a "daily rate," to a calculated number of locomotive days. The 14 SD70MACs for which a "daily lease expense" is reported in AEP Texas' workpapers[] are all covered by a long-term lease similar to the one AEP Texas used as the source for its annual lease payments.

BNSF Reply at III.C-4 (footnote omitted). This statement mis-represents how AEP Texas
(continued...)

BNSF agrees with the use of its long-term lease as the basis for SD70MAC locomotive lease rates but disagrees with the application of the lease payments. BNSF contends that AEP Texas should not have based its lease rates on actual BNSF 2000 lease payments. Instead of using the actual base year lease payment, BNSF calculated the present value of the stream of payments contained in the { } lease and divided this value by the number of years covered by the lease. BNSF's approach produces an annual lease cost in the base year of { } per locomotive unit. BNSF contends that its approach is more representative than that adopted by AEP Texas, and that AEP Texas' approach also falls short of capturing the total payments that will be made over the life of the lease. *See* BNSF Reply at III.D-6.

BNSF's approach suffers from several flaws. First, BNSF claims that using its methodology, *i.e.* calculating the base-year lease payment on a present value basis, means that it is not necessary to modify the mechanics of the DCF model to treat inflation differently for locomotive lease costs. BNSF states that applying inflation indexes within the DCF merely converts the lease costs in later years to nominal dollars, which is the

³ (...continued)
calculated the short-term lease rate. Nor has BNSF provided the "similar" lease it refers to. {

}

same way that other costs items are treated in the DCF model. *See* BNSF Reply at III.D-4. While this statement is technically correct, BNSF's actual calculations mismatch the inflation indexes used in its DCF model with those used to calculate the present value of the stream of lease payments, and thereby the base year lease cost. Stated differently, BNSF uses the RCAF-U to increase operating expenses throughout the life of its DCF model; however, when calculating the present value of the stream of lease payments BNSF forgoes use of the cost inflation index from its DCF model and substitutes the forecast of the equipment rents index included in the forecast of the RCAF-U, thus inappropriately mixing indexes. Had BNSF correctly used the same index to determine the present value of the stream of lease payments that its DCF model uses to determine operating costs in future periods, its base year SD70MAC lease payments would equal { } used by AEP Texas. *See* AEP Texas Reb. electronic workpaper file "Analysis of BNSF Loco Lease.xls."

On Rebuttal, AEP Texas continues to rely on the same locomotive lease rates it used in its Opening Evidence. Although the parties disagree with respect to the SD70MAC lease rate, they are in agreement with respect to the annual lease rate for SD40-2 locomotives ({ }). *See* BNSF Reply at III.D-5.

Table III-D-8 below compares the parties' respective 2000 locomotive lease costs.

TABLE III-D-8 Locomotive Lease Expenses				
Item	AEP Texas Opening	BNSF Reply	AEP Texas Rebuttal	Difference BNSF Reply/AEP Texas Rebuttal
No. of SD70MAC locomotives	242	232	221	11
Annual SD70MAC lease cost per unit	{ }	{ }	{ }	{ }
Total SD70MAC lease cost	{ }	{ }	{ }	{ }
No. of SD40-2 locomotives	47	55	49	6
Annual SD40-2 lease cost per unit	{ }	{ }	{ }	\$0
Total SD40-2 lease cost	{ }	{ }	{ }	{ }
Total locomotive lease cost	{ }	{ }	{ }	{ }

b. Maintenance

BNSF accepted AEP Texas' use of a locomotive maintenance contract provided by BNSF in discovery as the basis for the TNR's maintenance cost per locomotive unit-mile ("LUM"), but applied what it refers to as the "correct" mileage-tier rate based on its average number of LUMs per month per locomotive. *See* BNSF Reply at III.D-7. On Rebuttal, AEP Texas follows the same approach (using the same maintenance cost per LUM) and re-calculates the LUM-based component of locomotive maintenance costs based on the corrected average number of LUMs per month per

locomotive for its revised traffic group. The calculations are shown in Rebuttal electronic workpaper file “TNR Loco Maint_Rebuttal.xls.”

With respect to overhauls, BNSF accepts the annual overhaul cost specified by AEP Texas for SD40-2 locomotives, but not for SD70MACs because the BNSF maintenance agreement relied on by AEP Texas does not include labor costs. *Id.* at III.D-7 to 8. Specifically, BNSF states that the { } per overhaul for SD70MAC locomotives used by AEP Texas includes the cost of materials only, and that AEP Texas neglected to include the cost of labor. In its Reply evidence, BNSF bases the SD70MAC overhaul cost on an invoice which, according to BNSF, shows an overhaul cost of { } for 106 SD70MAC locomotives.

BNSF neglects to mention that { }

}. BNSF’s own workpaper shows that the actual cost to BNSF for those particular overhauls was { } per unit, not the { } claimed by BNSF. *See* BNSF Reply Workpaper Vol. I, p. III.D-0023.

Moreover, the invoice upon which BNSF based its SD70MAC overhaul cost predates by several years the contract that AEP Texas used as the basis for SD70MAC overhauls. The 106 locomotives mentioned in the invoice are relatively old, many having been acquired in 1994 and 1995, and are among the first SD70MACs to be

put into service by BNSF. In contrast, the TNR would have a much newer fleet. AEP Texas' maintenance estimates are based upon the recent 5th Amendment to the Amended and Restated Maintenance Agreement signed by BNSF and EMD in October 1999.⁴ This covers more recently-leased units, most acquired in 1998 and 1999.

On Opening, AEP Texas used { } per overhaul from a current EMD maintenance contract as the basis for SD70MAC overhaul costs, and then set the interval between overhauls at { } per requirements in the EMD contract. BNSF's overhaul interval is longer, { }, reflecting BNSF's assumed lower locomotive utilization. On Rebuttal, AEP Texas continues to use the same SD70MAC locomotive overhaul cost it used on Opening.

Table III-D-9 below summarizes and compares AEP Texas' and BNSF's locomotive maintenance costs.

⁴ See AEP Texas Op. Workpapers Vol. 17, pp. 08807-8820.

TABLE III-D-9 Locomotive Maintenance Costs				
Item	AEP Texas Opening	BNSF Reply	AEP Texas Rebuttal	Difference BNSF Reply/ AEP Texas Rebuttal
SD70MAC locomotive unit miles	31,995,113	27,726,754	31,810,856	(4,084,102)
Cost/LUM	{ }	{ }	{ }	{ }
Annual maintenance SD70ACs	{ }	{ }	{ }	{ }
Annual overhaul charge/unit SD70MACs	{ }	{ }	{ }	{ }
Total SD70MACs	229	232	221	11
Total overhaul cost for SD70MACs	{ }	{ }	{ }	{ }
SD40-2 locomotive unit miles	2,020,572	2,144,724	2,111,614	33,110
Cost/LUM	{ }	{ }	{ }	{ }
Annual maintenance SD40-2s	{ }	{ }	{ }	{ }
Annual overhaul charge/unit SD40-2s	{ }	{ }	{ }	{ }
Total SD40-2s	47	55	49	6
Total overhaul cost for SD40-2s	{ }	{ }	{ }	{ }
Total annual locomotive maintenance costs	{ }	{ }	{ }	{ }

c. Servicing

BNSF accepts AEP Texas' use of the BNSF 2000 R-1 as the basic source for developing a locomotive servicing (sanding and lubrication) cost per LUM. *See* BNSF Reply at III.D-9. However, BNSF "takes issue with AEP Texas [sic] exclusion of costs reported to a yard operations account." *Id.* To account for this exclusion, BNSF

recalculates the locomotive servicing cost from its R-1 and increases the locomotive servicing cost used by AEP Texas from { } per locomotive unit-mile.⁵

BNSF's methodology incorrectly assumes that the TNR's mix of yard and road LUMs matches BNSF's real-world mix of yard and road LUMs. Review of BNSF's 2000 R-1 shows that 13.8 million or 3.01 percent of BNSF's total locomotive unit-miles are associated with yard operations. By way of contrast, based on the conservative assumption that each of the TNR's five switch locomotives operate 24 hours per day seven days per week for the entire year, these locomotives would produce only 262,800 yard LUMs which is 0.77 percent of the TNR's total LUMs. Stated differently, BNSF's yard LUMs are 3.9 times greater as a percentage of total LUMs than the TNR's ($3.01/0.77 = 3.9$). Using BNSF's mix of LUMs to calculate the locomotive servicing cost per mile thus substantially overstates the TNR's locomotive servicing cost.

d. Fuel

i. Fueling Locations

As described on Opening, Mr. Reistrup's operating plan for the TNR calls for two primary locomotive fueling points: Alliance Yard in Nebraska and Las Animas Yard in Colorado. All locomotives on all trains that move through Alliance are fueled in

⁵ To arrive at this number BNSF divides total locomotive servicing costs by locomotive unit-miles. AEP Texas' calculation is based on locomotive servicing cost and LUMs associated with road trains and road train switching only. BNSF's calculation includes yard locomotive servicing costs, which produces a cost of { } per LUM.

the empty (northbound) direction at Alliance, and all locomotives on all trains that move through Las Animas are fueled in the loaded (southbound) direction at Las Animas. Both parties agree that the Alliance Yard should have permanent fuel racks. On Opening, Mr. Reistrup provided for fueling by tanker trucks (“direct-to-locomotive” or “DTL” fueling in BNSF’s terminology) at Las Animas. On Rebuttal, Mr. Reistrup has agreed with BNSF that permanent fuel racks should be provided at Las Animas.⁶ The locomotives on empty coal trains that do not move through Alliance (*i.e.*, trains moving between TNR-served PRB mines and the BNSF interchange at Campbell or South Logan) are fueled as necessary by tanker truck at Campbell or South Logan. Although AEP Texas did not mention the fueling of helper locomotives in its Opening Narrative, Mr. Reistrup’s plan also provides for fueling helper locomotives by tanker truck.

Under Mr. Reistrup’s operating plan, locomotives on the non-coal overhead trains moving in both directions between Amarillo and Oklaunion are not fueled by the TNR. Fueling of these locomotives is performed on the residual BNSF, and the TNR compensates BNSF for fuel on the basis of BNSF’s 2000 average cost of fuel per diesel unit-mile. *See* AEP Texas Op. at III-D-4. BNSF did not mention the fueling of locomotives on the non-coal overhead trains in its Reply evidence, and thus has accepted this aspect of Mr. Reistrup’s operating plan.

⁶ BNSF proposed permanent fuel racks for its Amarillo Yard which is the equivalent of the TNR’s Las Animas Yard. As discussed in Part III-B, *supra*, AEP Texas retains Las Animas as the location of the TNR’s southern fueling and inspection facility.

BNSF and AEP Texas thus agree on the fueling plan for the TNR's locomotives, except for (1) BNSF's proposal to move the Las Animas yard to Amarillo, and (2) BNSF's argument that locomotives should be fueled on trains moving in both directions at Las Animas/Amarillo rather than in the loaded direction only. Mr. Reistrup has explained in detail why both the Las Animas yard location and his plan to fuel locomotives only in the loaded-train direction are feasible at pp. III-B-33 to 50, *supra*. That discussion will not be repeated here.

ii. Fuel Cost

The TNR's fuel cost has two components: a cost per gallon and a consumption rate (usually expressed as gallons per diesel unit-mile). AEP Texas' Opening fuel costs for the TNR were calculated using BNSF's system-average cost of diesel fuel and its system-average fuel consumption rate, applied to the TNR's gross ton-miles and diesel unit-miles. *See* AEP Texas Op. at III-D-4 to 5.

BNSF disagrees with both fuel cost components used by AEP Texas. BNSF asserts that the real-world cost of fuel is higher than system average at the two principal locations where the TNR fuels its locomotives (Alliance and, in BNSF's scenario, Amarillo⁷); that the TNR would have to incur BNSF's real-world fuel costs; and

⁷ Because BNSF proposes to fuel locomotives at Amarillo rather than Las Animas, BNSF developed "real-world" costs for fuel delivered to Amarillo rather than Las Animas. As discussed earlier, AEP Texas disagrees that fueling should be moved to Amarillo and retains Las Animas as the TNR's southerly fueling point.

that an add-on must be applied at locations where fueling is performed by tanker truck to cover the additional cost of DTL service. *See* BNSF Reply at III.D-11 to 17.

(a) Fuel Cost/Price

On Reply, BNSF presented evidence concerning its own real-world fuel costs per gallon at Alliance and Amarillo, as well as the alleged cost of dispensing fuel using DTL service (contractor tanker trucks). BNSF argues that its real-world fuel cost justifies a higher cost per gallon for the TNR in 2000 than its system-average cost.

Fuel Costs at Alliance and Amarillo/Las Animas. BNSF states that it purchases most of the diesel fuel it uses at Alliance from a fuel supplier in Tulsa, OK. The fuel is transported by pipeline from Tulsa to Des Moines, IA, loaded into rail tank cars, and transported by BNSF from des Moines to Alliance. BNSF estimates that its average delivered fuel cost at Alliance (including taxes and environmental fees) in 2000 (the first year of TNR operations) was { } per gallon. *See* BNSF Reply at III.D-11 to 12 and Reply Exhibit III.D-2. This cost is { } higher than BNSF's 2000 system-average cost of fuel which was \$0.755 per gallon as reflected in its 2000 R-1.

BNSF also provided an estimate of its 2000 real-world cost of fuel at Amarillo. BNSF obtains its fuel at that location from a refinery and distribution terminal located near Amarillo, via an existing pipeline that connects the distribution terminal with BNSF's fuel tanks at the Amarillo yard. BNSF estimated that its delivered cost of fuel at

Amarillo in 2000 was { } per gallon, or only { } than its delivered fuel cost at Alliance. *See* BNSF Reply at III.D-12 and Reply Exhibit III.D-2.

BNSF's fuel cost calculations for the TNR are based on its estimates of its own real-world cost of diesel fuel at Alliance and Amarillo, not on the cost of diesel fuel that the TNR would be likely to experience under Mr. Reistrup's operating plan. AEP Texas Witness George L. Donkin, an expert in energy and pipeline economics, views this difference as a fatal flaw in BNSF's fuel cost calculations for the TNR. BNSF's approach is fatally flawed because it fails to recognize that the relevant diesel fuel market, including the related transportation delivery system infrastructure needed to supply the TNR's diesel fuel requirements at Amarillo and Las Animas,⁸ as well as BNSF's other diesel fuel requirements at Alliance, would be totally different from that which BNSF experienced on a real-world basis in the year 2000. According to Mr. Donkin, with a totally different relevant diesel fuel market and related transportation delivery system infrastructure, the TNR would be in a position to obtain its diesel fuel requirements at Alliance on more favorable terms and costs than BNSF experienced in 2000.

A significant difference in the real-world situation and the stand-alone situation presented by the TNR is that the quantities of diesel fuel that the TNR uses in 2000 at Alliance and Las Animas (or Amarillo, under BNSF's scenario) are considerably

⁸ As noted above, Mr. Reistrup's operating plan calls for the TNR to fuel locomotives at Las Animas rather than Amarillo.

larger than the quantities used by BNSF. At the calendar year 2000 level, the TNR's locomotives consume 73.0 million gallons of diesel fuel at Alliance and 23.2 million gallons at Las Animas. *See* AEP Texas Reb. electronic workpaper file "TNR Fuel by Location.xls." According to BNSF Reply Exhibit III.D-2, BNSF's real-world usage of diesel fuel in 2000 was { } million gallons at Alliance and { } million gallons at Amarillo. Thus, the TNR's fuel requirement at Alliance is { } percent greater than BNSF's, and the TNR's fuel requirement at Las Animas is { } percent greater than BNSF's at Amarillo.

In Mr. Donkin's judgment, the significantly greater annual diesel fuel requirements of the TNR at Alliance and Las Animas, layered on top of BNSF's remaining diesel fuel requirements at Alliance, in particular, would result in far more favorable diesel fuel market conditions and physical fuel transportation delivery system infrastructures, from the buyer's perspective, than those that existed for BNSF in 2000.

At Alliance, BNSF's calculation of its average delivered fuel cost in 2000 is based on purchasing most of that fuel in Tulsa, OK, transporting it by pipeline from Tulsa to Des Moines, IA, and transferring it to railcars for shipment from Des Moines to Alliance. It is highly unlikely that the same purchasing and transportation scenario would occur if the transportation infrastructure were designed to meet the TNR's much larger annual diesel fuel requirements at Alliance.

In support of this conclusion, Mr. Donkin prepared AEP Texas Rebuttal Exhibit III-D-1, which summarizes the results of his analysis of the refinery capacity that is available to serve the Alliance and Las Animas diesel fuel markets from various locations. The exhibit shows that significant refinery capacity exists at numerous locations that are much closer to Alliance than Tulsa, where BNSF purchased most of the diesel fuel that was used to fuel its locomotives at Alliance in 2000. Mr. Donkin concludes that under Mr. Reistrup's operating plan for the TNR, which calls for significantly larger fuel quantities at Alliance than BNSF uses, the TNR's delivered cost of diesel fuel at Alliance from the menu of refinery sources shown in Exhibit III-D-1, with an optimally designed, cost-minimizing transportation delivery system infrastructure, would be significantly below BNSF's estimated calendar year 2000 cost.

With respect to the diesel fuel transportation delivery system, the TNR starts operations from Day 1 with an annual fuel requirement of 73 million gallons, or an average of 200,000 gallons per day. The latter figure translates to about 4,762 barrels per day. In the stand-alone world, it is logical to assume that a diesel fuel producer would construct a pipeline to transport this very large volume from one of the refinery locations shown in Exhibit III-D-1 to Alliance – and would increase refining capacity as needed to accommodate the volume. Although the capital (construction) costs of such a pipeline would be recovered in the delivered fuel price, Mr. Donkin has little doubt that the result

would be far more favorable than the fuel cost produced by BNSF's current unwieldy, two-mode fuel delivery process.

Mr. Donkin is also very skeptical of BNSF's cost calculations for the TNR's Amarillo diesel fuel requirements (which would actually be received at Las Animas under Mr. Reistrup's operating plan). Mr. Donkin points out that diesel fuel costs in the Texas Panhandle area – where Amarillo is located – are typically among the lowest in the United States due to its proximity to the producing and refining facilities in the area. Accordingly, BNSF should be able to obtain diesel fuel at Amarillo at a cost that is *below* its system-average fuel cost. Yet BNSF's purported cost of fuel at Amarillo in 2000 was more than { } higher than its system-average cost. It was also a mere { } per gallon less than BNSF's delivered cost of fuel at Alliance, notwithstanding that most of BNSF's Alliance fuel supplies were transported a substantial distance (well over 750 miles) from Tulsa, OK to Alliance by a combination of pipeline and tank car.⁹

⁹ BNSF provided no workpaper support for its development of 2000 fuel costs at Alliance and Amarillo. In response to a request by AEP Texas for information supporting the numbers in BNSF Exhibit III.D-2, BNSF simply referred to the fuel consumption and price data maintained by its Fuel Management group (described in its Reply Narrative) and stated: "As to the accuracy of the price and volume data contained in BNSF's Exhibit III.D-2, those data were sponsored through sworn testimony from Lonnie Jarrell, Director Fuel Logistics, in its Reply Evidence." *See* AEP Texas Reb. Workpapers Vol. 2, p. 00583. This is hardly the kind of substantive evidence required to justify an upward adjustment from system-average fuel prices. BNSF's fuel costs are unsubstantiated and should be rejected.

In addition, even if BNSF's estimated 2000 cost for diesel fuel delivered to its locomotive fueling facilities at Amarillo is accurate, Mr. Donkin believes that the delivered cost for the TNR's diesel fuel requirements at Las Animas would likely be significantly lower than BNSF's comparable estimated delivered cost at Alliance, *i.e.*, significantly lower than { } per gallon. Mr. Donkin reaches this conclusion on the basis of the refinery capacity information presented in Exhibit III-D-1, which demonstrates that there are numerous refineries with significant capacity at locations much closer to Las Animas than the distance from Tulsa, OK to Alliance.

Based on the locomotive fueling aspects of Mr. Reistrup's operating plan for the TNR and on Mr. Donkin's analysis and conclusions regarding BNSF's fuel cost calculations for the TNR, it is apparent that BNSF has failed to justify saddling the TNR with the high delivered fuel costs it proposes for the fuel used at Alliance and Amarillo. AEP Texas therefore continues to calculate the TNR's fuel costs using BNSF's system-average cost of diesel fuel.

Fuel Costs at Other Locations. Although AEP Texas has now provided for fueling of locomotives at both Alliance and Las Animas using permanent fueling facilities (which is similar to BNSF's proposal), DTL service using tanker trucks will still be used to fuel road locomotives at Campbell and South Logan for coal trains that do not move through Alliance, as well as for helper locomotives. The estimated annual fuel consumption at these points is shown in AEP Texas Rebuttal electronic workpaper file

“TNR Fuel by Location.xls.”¹⁰ BNSF asserts that an additional \$ { } must be added to the cost of the fuel itself to cover the cost of providing DTL service. According to BNSF, this represents the average amount it paid to DTL providers in 2000. See BNSF Reply at III.D-13 to 14.

BNSF did not provide any supporting documentation for its proposed DTL cost additive as described in its narrative. Under the STB’s regulations governing the information to be provided in a rail carrier’s R-1, the cost of dispensing fuel by truck is included in the system average fuel cost.¹¹ BNSF has failed to present any evidence showing that the cost of DTL service is not covered by its system-average cost of dispensing fuel. In these circumstances the Board should reject BNSF’s proposed additive for DTL service. See *Duke/NS* at 69 (rejecting the defendant’s proposed adder for the labor cost associated with the use of contractors to fuel locomotives because “[t]he R-1 expenses include an embedded labor component in the storage and dispensing costs [and] NS’s fuel cost is unsupported.”). For these reasons, AEP Texas continues to use BNSF’s system-average fuel cost per gallon at the DTL fuel locations.

¹⁰ The number of gallons of fuel attributable to the TNR’s general freight traffic that moves overhead between Amarillo and Oklaunion is also shown in the spreadsheet, although the TNR does not provide fueling service for these trains.

¹¹ See 49 C.F.R. Part 1201, Operating Expense Accounts, Paragraph (67): “Locomotive Fuel—Cost of locomotive fuel used in all service, including the receipt, storage *and dispensing* of the fuel” (emphasis supplied).

(b) Fuel Consumption

BNSF disputes AEP Texas' use of a BNSF system-average fuel consumption rate per gross ton-mile and diesel unit-mile which it developed from BNSF's 2000 URCS.¹² BNSF points out that the TNR's trains are predominantly long, heavy unit coal trains that move over "difficult" terrain, and argues that "there is no reason to believe that a railroad handling unit coal trains in the west would consume fuel at the average fuel consumption rate for the incumbent's entire fleet of trains." *See* BNSF Reply at III.D-14. BNSF therefore proposes to use the higher fuel consumption rates from special fuel studies based on locomotive event recorder data¹³ that were performed in the *TMPA* rate case (for coal trains moving beyond Denver) and the *PSCo/Xcel* rate case (for coal trains that do not move beyond Denver), instead of system-average fuel consumption rates, in calculating annual fuel consumption and fuel consumption costs for the TNR's coal trains. *Id.* at III.D-15 to 17.¹⁴

¹² Specifically, AEP Texas calculated a weighted average fuel consumption rate for all trains moving on the TNR of 3.24 gallons per locomotive unit-mile and applied this consumption rate to all LUMs including those for coal trains, non-coal trains and helpers. *See* AEP Texas Op. electronic workpaper file "TNR Fuel Consumption.xls."

¹³ AEP Texas pointed out some of the problems with using event recorder data to estimate locomotive fuel consumption beginning at page II-A-74 of its Reply Evidence Narrative in this case, as well as at Part II-A-8, *supra*. Those discussions are incorporated herein by reference.

¹⁴ For the TNR's non-coal trains, BNSF used the system-average fuel consumption rate for non-coal trains from AEP Texas' Opening analysis. *See* BNSF Reply electronic workpaper file "Total TNR Fuel.xls."

In the absence of evidence demonstrating the comparability of the various movements in question, it is inappropriate to apply the results of a special study of real-world trains conducted in one case to the SARR trains involved in another case, and the Board should reject BNSF's attempt to do so here. *See, e.g., Wisconsin* at 54-55. Such an application of results is inappropriate in this instance because BNSF's statement that the *TMPA* and *PSCo/Xcel* coal trains are similar to the TNR's coal trains in terms of size and route of movement (Reply at III.D-16 to 17) is inaccurate.

As a preliminary matter, AEP Texas notes that its ability to respond in detail to BNSF's fuel-consumption comparisons is limited because BNSF refused AEP Texas' request that it provide the Quantum Engineering, Inc. event recorder software that was used to extract and analyze data from the event recorders on the locomotives involved in the *TMPA* and *PSCo/Xcel* special fuel studies.¹⁵ *TMPA*'s counsel (who also are representing AEP Texas in this proceeding) obtained a license to use the Quantum software for purposes of the *TMPA* proceeding only, at considerable cost to their client, prior to the submission of any evidence in that proceeding. Under the terms of the license

¹⁵ *See* Letter from BNSF counsel dated June 24, 2004, in AEP Texas Reb. Workpapers Vol. 2, pp. 00586-592. As noted in that letter, BNSF authorized AEP Texas' counsel and experts who have executed the Highly Confidential Undertaking in the Board's Protective Order in this proceeding to review the event recorder data files from the *TMPA* fuel study, and it belatedly provided the data files collected during the *PSCo/Xcel* fuel study. However, BNSF's refusal to provide the computer software needed to analyze those files makes their production largely meaningless.

the copy of the software provided to TMPA's counsel had to be returned after the close of the record in that proceeding.

AEP Texas should not be required to spend a substantial sum to re-license the software for purposes of presenting rebuttal evidence in this case. BNSF's reliance on the *TMPA* and *PSCo/Xcel* fuel studies and the Quantum software for purposes of this case means BNSF had a duty to provide that software to AEP Texas either in discovery or as part of its workpapers. BNSF's failure to do so prevents AEP Texas' experts from fully evaluating the comparability of the trains involved in *TMPA* and *PSCo* fuel studies to the TNR's trains. BNSF's attempt to impute the study results from those cases to this case should be rejected for this reason alone.

In addition, in discovery, AEP Texas requested that BNSF provide information concerning fuel studies involving PRB coal movements over all or a portion of the AEP Texas/Oklahoma routes. In the letter from BNSF's counsel to AEP Texas' counsel dated November 24, 2003 (*see* AEP Texas Reb. Workpapers Vol. 2, pp. 00588-589), BNSF essentially stated that it had not conducted any such studies or analyses. Yet, BNSF submitted in its Reply evidence both the results of a special fuel study it conducted in the Fall of 2003 with respect to the AEP Texas trains, and the results of the *TMPA* and *PSCo/Xcel* studies (which at the time were covered by protective orders in those cases, which meant that AEP Texas' counsel and consultants did not have access to them for purposes of this case).

The Board has previously ruled that a defendant's failure to provide relevant information in its possession in discovery precludes it from using the information in its evidence. *FMC* at 28; *see also PSCo/Xcel* at 93 ("Xcel reasonably relied on the information received from BNSF and BNSF may not impeach that evidence with information it failed to produce during discovery."). The Board should disregard the results of the *TMPA* and *PSCo/Xcel* fuel studies for purposes of this case.

In any event, the trains involved in the *TMPA* and *PSCo* fuel studies differ from the TNR's trains in several important respects. The *TMPA* and *PSCo/Xcel* study trains were real-world trains moving via BNSF to those utilities in 2001 and 2002, respectively. BNSF presented no evidence that the TNR's trains are similar in size, weight and locomotive consist/configuration to the *TMPA* and *PSCo/Xcel* study trains other than a comparison of the average number of cars per train in the *TMPA* study with a broad range of TNR train sizes (BNSF Reply at III.D-16 n.31). Moreover, BNSF effectively acknowledges the invalidity of its comparison conceding that the AEP Texas coal trains involved in a fuel consumption study during the third and fourth quarter of 2003, the results of which were used by BNSF in calculating variable costs for the issue traffic, "were not representative of TNR trains." *Id.*¹⁶

¹⁶ The size of the AEP Texas/Oklahoma trains increased from { } cars to { } cars beginning in { }, and the locomotive configuration also changed ({ }). Other TNR coal trains have also changed (continued...)

Second, the TNR's route is *not* the same as the routes of the coal trains that were the subject of the fuel studies in *TMPA* and *PSCo/Xcel*. The *TMPA* and *PSCo* study trains originated in the PRB, but they moved over BNSF's southern route out of the PRB, via Guernsey, WY. The TNR's coal trains move over BNSF's northern route out of the PRB, via Edgemont, SD and Alliance, NE. (The two routes converge at Northport, NE.) BNSF has not shown that the TNR's northern route – which geographically is more than 75 miles distant from BNSF's southern route in several places – is comparable to the route involved in the *TMPA* and *PSCo/Xcel* fuel studies in terms of characteristics that may affect locomotive fuel consumption.

The *TMPA* study-train route is also different from the TNR's route for a considerable distance (more than 300 miles) south of Pueblo, CO. The *TMPA* study trains operated between Pueblo and Amarillo via Trinidad, CO and Texline and Dalhart, TX. The TNR's coal trains operate via La Junta and Las Animas Jct., CO and Stratford, TX.¹⁷ The route via La Junta/Las Animas Jct. is slightly shorter, and has fewer grades and curves, than the route via Trinidad. This can be confirmed by a comparison of

¹⁶ (...continued)
size since the 2000 base year. For example, {

}.

¹⁷ These alternative routes are shown in AEP Texas Op. Exhibit III-A-4. {
}. See AEP Texas Op. at III-B-2 to 3.

BNSF's track charts for the route via LaJunta/Las Animas Jct. (Pueblo, La Junta and Boise City Subdivisions – *see* AEP Texas Op. Workpapers Vol. 16, pp. 08081-8166) with the track charts for the route via Trinidad (Dalhart, Spanish Peaks and Twin Peaks Subdivisions – *see* AEP Texas Op. Workpapers Vol. 16, pp. 08300-8392). The BNSF route via Trinidad skirts the Sangre de Cristo mountain range, and during his field trip to the region in October-November of 2003, Mr. Reistrup confirmed that the route via La Junta and Las Animas is straighter and flatter than the route via Trinidad.

Third, the fuel consumption tables used by BNSF in the *TMPA* and *PSCo/Xcel* fuel studies appear to overstate the actual fuel consumption of SD70MAC locomotives. These tables were included in BNSF's Reply workpapers in this case; *see* Vol. I, pp. III.D-0092 and 0390. Neither of those tables indicates the origin or derivation of the fuel consumption rates shown, and in response to a follow-up workpaper request by AEP Texas BNSF simply stated that "BNSF's witnesses previously testified that these tables were obtained from the locomotive manufacturers."¹⁸ There are, in fact, other fuel consumption tables for SD70MAC locomotives, including one used by BNSF itself in connection with its Train Performance Model, which it uses in the ordinary course of business. The latter table has lower consumption rates than those shown in the tables used in the *TMPA* and *PSCo/Xcel* fuel studies. *See* AEP Texas' Reply Narrative at II-A-

¹⁸ *See* the excerpt from BNSF's Responses and Objections to Complainant's Second Request for Workpapers included in AEP Texas Reb. Workpapers Vol. 2, p. 00583.

81; *also* compare BNSF Op. workpaper Vol. I, p. II.A-0028 with BNSF Reply workpaper Vol. I, pp. III.D-0092 and 0390.

Finally, BNSF's generalization that the locomotives transporting unit coal trains are likely to consume more fuel than system average (BNSF Reply at III.D-14) is belied by several known facts. First, BNSF's coal trains are transported by its most modern, high-horsepower, fuel-efficient locomotives, primarily SD70MACs. Second, coal trains do not start and stop as often as other trains, as they operate as a unit without the need for intermediate switching. Third, BNSF has the highest percentage of intermodal traffic of any Class I railroad. In 2003, intermodal traffic represented { } percent of BNSF's total traffic mix by volume (coal represented { } percent).¹⁹

Because of the service-sensitive nature of intermodal traffic BNSF operates intermodal power at higher speeds than other trains, and to maintain these higher speeds it operates intermodal trains with higher horsepower per ton ("HPT") ratios than coal trains. Intermodal trains operate, on average, with { } HPT, and this ratio can jump to as high as { } HPT on the ultra-sensitive "Z" trains. Loaded coal trains, on the other hand, normally operate with between { } HPT.²⁰ This results in a higher fuel consumption rate per LUM (or per gross ton-mile) than for other traffic including coal,

¹⁹ See BNSF's Weekly Intermodal and Carload Units Report, reproduced in AEP Texas Reb. Workpapers Vol. 2, p. 00598.

²⁰ See AEP Texas Reb. Workpapers Vol. 2, pp. 00593-603, and BNSF Reply workpapers at Vol. I, pp. III.D-0408 and 0409; Vol. II, p. III.D-0580.

which means that BNSF's fuel consumption for coal trains is likely to be closer to the system average.

For all of the reasons set forth above, the Board should reject BNSF's calculation of TNR fuel consumption rates and fuel costs using the results of the *TMPA* and *PSCo/Xcel* studies and should accept AEP Texas' calculations using system-average fuel consumption rates.

2. Railcars

a. Leasing

BNSF accepts AEP Texas' leasing and maintenance costs of { } for the railcars used for the TNR's non-coal traffic. BNSF also accepts AEP Texas' leasing and maintenance unit costs for coal cars, but applies them to a different fleet size. See BNSF Reply at III.D-17 to 18. AEP Texas continues to use the same lease rates and maintenance costs for railroad-provided coal cars on Rebuttal.²¹ The number of railroad-provided coal cars is addressed in Part III-C, *supra*.

The following table compares the parties' freight car leasing costs:

²¹ BNSF indicates that in AEP Texas' Second Errata there was an incorrect link in the underlying workpapers which resulted in an understatement of railroad-provided car costs. BNSF Reply at III.D-28. This linking error has been corrected on Rebuttal.

TABLE III-D-10 <u>Comparison of Freight Car Leasing Costs</u>				
Item	AEP Texas Opening	BNSF Reply	AEP Texas Rebuttal	Difference BNSF Reply/AEP Texas Rebuttal
<u>No. of RR-owned Coal Cars</u> ^{1/}				
1. H and K - Hoppers	247	128	484	(356)
2. J - Gondolas	535	509	830	(321)
<u>RR-owned Coal Car Lease Rates</u>				
3. H ND k - Hoppers	{ }	{ }	{ }	\$0
4. J - Gondolas	{ }	{ }	{ }	{ }
<u>RR-owned Coal Car Lease Costs</u>				
5. H and K - Hoppers	{ }	{ }	{ }	{ }
6. J - Gondolas	{ }	{ }	{ }	{ }
7. Total lease costs	{ }	{ }	{ }	{ }
^{1/} See AEP Texas Reb. electronic worksheet file "TNR Car Costs_Rebut.xls."				

3. **Personnel**

a. **Operating**

On Opening, AEP Texas treated the TNR's Operating personnel as including employees performing the Transportation, Mechanical and Maintenance-of-Way functions. On Reply, BNSF treated these functions separately (*i.e.*, it treated only employees involved in the Transportation function as Operating personnel and treated Mechanical and Engineering employees as Non-Operating personnel). In addition, BNSF treated several positions that AEP Texas included as General & Administrative ("G&A") employees as Operating employees.

For purposes of its Rebuttal evidence, in order to facilitate comparisons between the parties' evidence on staffing, AEP Texas generally follows BNSF's format. Consistent with recent precedent (*TMPA* at 94 n.158), AEP Texas also treats three positions (the Director of Operations Control, the Director of Train and Locomotive Operations, the Director of Operating Rules and Safety) as Operating employees rather than G&A employees.²²

i. Staffing Requirements

The differences between the parties' Operating personnel for the TNR (with the changes in AEP Texas' staff classifications described above) are shown in Table III-D-11 below. Three of the positions shown in the table (the Director of Operations Control, Director of Train and Locomotive Operations and Manager of Operating Rules and Safety) were included as G&A personnel in AEP Texas' Opening evidence. On Rebuttal, AEP Texas has moved them to Operating personnel which is where BNSF has placed them.

²² BNSF also proposes to treat the TNR's Director of Customer Service and Customer Service managers as Operating employees. For the reasons set forth in Part III-D-3-c, *infra*, AEP Texas believes these employees are more appropriately treated as G&A employees and thus continues to include them in the G&A category.

**TABLE III-D-11
TNR Operating Personnel - 2000**

Position	AEP Texas/ Opening	BNSF/ Reply	AEP Texas/ Rebuttal	Difference (Reb. v. Reply)
Director of Operations Control	1	1	1	0
Manager of Operations Control	5	5	5	0
Crew Callers	5	5	5	0
Dispatchers	18	18	18	0
Director of Train and Locomotive Operations	1	1	1	0
Manager of Train Operations	9	9	9	0
Assistant Manager of Train Operations	23	22	22	0
Train and Helper Crew Members	487	473 ^{1/}	497	24
Switch and Work Train Crew Members	27	42	31	(11)
Crew Hauler/Utility Clerk	0	5	0	(5)
Manager of Locomotive Operations	9	8	8	0
Hostlers	0	24	0	(24)
Manager of Operating Rules and Safety	1	1	1	0
Total	593	614	598	16

^{1/} BNSF's T&E employee count is lower than AEP Texas' because of its reduced traffic group resulting from its improper exclusion of certain coal traffic, which reduces the number of coal trains operated by the TNR.

T&E Crew Members. The difference between the parties with respect to the TNR's train and helper crew members is a function of (1) their differences in the TNR's traffic group (on Rebuttal, AEP Texas restored most of the coal traffic originating at the southernmost PRB mines served by the Orin Subdivision that BNSF had removed), and (2) BNSF's assumption that the TNR must be overstaffed 51 weeks of the year in order to provide sufficient train crews for the one peak week of the year.

Similar to BNSF's position with respect to locomotives and railcars, BNSF's apparent position is that the TNR would need to maintain capacity to meet its peak requirements at all times. This approach is particularly inappropriate with respect to T&E staffing because AEP Texas already assumes that train crews do not work 365 days per year. Rather, crews have 95 days off per year – thus there is already a built-in “spare margin” for trains crews.

BNSF's position mistakenly assumes that the scheduling of on-days and off-days is completely inflexible, so that during the peak week the same number of crews have a day off as during any other week of the year and none of these crews can be scheduled to work more days during the peak period. Stated differently, to justify its high number of crews, BNSF makes the nonsensical assumption that crews will be working the same number of shifts every week of the year as they work during the peak week.

BNSF's approach creates an inconsistency between the supply and demand for train crews. BNSF assumes that the TNR will supply crews to meet the peak week

requirements, yet the TNR's traffic only demands average staffing levels over the year. It is mathematically impossible for train crews to be staffed for the peak week and still work 270 shifts per year. When one accounts for the difference in the peak week to average week, it is apparent that BNSF is assuming that T&E employees work only 245 shifts per year. Table III-D-12 below calculates BNSF's crew starts correcting for BNSF's error.

TABLE III-D-12 Calculation of BNSF Actual TNR Crew Starts		
<u>Item</u>	<u>Amount</u>	<u>Source</u>
1. Peak Week 2020 train count	311	"Peaking Factor.xls"
2. Annual train count	14,750	"Peaking Factor.xls"
3. Average trains per week	282.9	Line 2 / (365/7)
4. Peak week peaking factor	109.9	Line 1 / Line 3
5. Peak week road crew starts	1,141	"BNSF Crew Counts.xls"
6. Peak week road crew shifts	2,282	Line 5 * 2
7. Average week road crew shifts	2,076	Line 6 / Line 4
8. Total annual road crew shifts	108,230	Line 7 / (365/7)
9. BNSF road crew personnel	441	"BNSF Crew Counts.xls"
10. Actual shifts per road crew employee	245	Line 8 / Line 9

The impact of BNSF's proposed staffing on crew utilization during the average week results in enormous numbers of employees who are idle most of the time. As shown in Table III-D-13 below, under BNSF's scenario the TNR would require 441 employees in the peak year, yet only 326 employees would be working on the average day in the peak week of the peak year. Thus, BNSF would have the TNR employ 115 road

crew members (441 - 326 = 115) whose only function is to ensure that the other employees would be no more likely to work during the peak week than any other week of the year. Stated differently, under BNSF's method, 115 T&E employees would have the day off each day during the TNR's peak week. Moreover, as also shown in Table III-D-13, during the peak week of the peak year 144 road crew members would have the day off each day during the average week. Under BNSF's plan only 297 road crew members are required each day during the average week, yet BNSF would staff the TNR with 441 road-crew employees or 48 percent more than the number required.

TABLE III-D-13 T&E Employees Available and Not Working		
<u>Item</u>	<u>2020 Peak Week</u>	<u>Source</u>
<u>Peak Week</u>		
1. Peak week crew starts	1,141	"BNSF Crew Counts.xls"
2. Peak week average crew starts per day	163	Line 1 / 7
3. Peak week average shifts per day	326	Line 2 * 2
4. Peak week crews available	441	"BNSF Crew Counts.xls"
5. Crews available and not working	115	Line 4 - Line 3
<u>Average Week Employees Available</u>		
6. Average week/peak week trains	109.9	"Peaking Factor.xls"
7. Average week shifts/day	297	Line 3 / Line 6
8. Crews available	441	"BNSF Crew Counts.xls"
9. Crews available and not working	144	Line 8 - Line 7
10. Crews available / crews working	1.48	Line 8 / Line 7

BNSF's approach is entirely inconsistent with the concept of a least-cost, most-efficient railroad. BNSF is also misleading when it states on the one hand that it

assumes crews work 270 shifts per year, when in reality these individuals could really only work 245 shifts per year.

Finally, basing the TNR's crew requirements on the peak-week, peak-year requirements, as BNSF proposes, is inconsistent with the Board's decision in *PSCo/Xcel*. In that case, the Board indicated that basing the number of crews required on the peak week "is the equivalent of a retail store staffing for the December holiday season levels throughout the year." *Id.* at 62. In sum, BNSF has completely failed to justify its peak-week analysis.

* * *

The difference between the parties for all other positions except T&E/helper crews is a total of 40 employees, of which 24 are hostlers. The differences between the parties with respect to the categories where there remains a disagreement are discussed below.

Assistant Manager of Train Operations. BNSF provides 22 employees to staff this field position. AEP Texas provides 23. In a footnote on page III.D-19 of its Reply Narrative, BNSF notes that AEP Texas specified 23 employees for this position in its Opening Narrative but that its workpapers included costs for only 21 employees. AEP Texas agrees with BNSF that the correct number of employees for this position is 22 because there is no need to station an Assistant manager of Train Operations at South

Logan as no train crews are based there. *See* BNSF Reply at III.D-20 and AEP Texas Rebuttal at III-C-57 to 58. On Rebuttal, AEP Texas includes costs for 22 employees.

Manager of Locomotive Operations. AEP Texas agrees with BNSF's proposal to reduce the number of employees for this position by one because, for the same reasons that apply with respect to the Assistant Manager of Train Operations, there is no need to station a Manager of Locomotive Operations at South Logan.

Switch and Work Train Crew Members. On Opening, AEP Texas provided a total of 27 switch crew members to man the switch locomotives stationed at Alliance and Las Animas yards on a 24/7 basis. AEP Texas did not provide any crew members for work trains. On Rebuttal, AEP Texas has added two SD40-2 locomotives to be used in work train service (*see* pp. III-C-26 to 28, *supra*). The TNR also needs four crew members (two for each work-train locomotive) who will be on duty five days a week. This is consistent with BNSF's work-train staffing, except BNSF proposes four work trains for the TNR instead of two. *See* BNSF Reply at III.D-24. This increases AEP Texas' Opening staffing for switch and work train crew members from 27 to 31.

BNSF accepts the number of helper and switch crew assignments proposed by AEP Texas, as set forth in Mr. Reistrup's operating plan for the TNR. BNSF Reply at III.D-23. However BNSF, asserts that helper and switch personnel cannot work 270 12-hour shifts per year, as proposed by AEP Texas, and should be given eight-hour shifts if

they are to perform 270 shifts per year. *Id.* This assertion appears to be based on nothing more than the unsupported opinion of BNSF's operating witness, Mr. Mueller.

Mr. Reistrup disagrees with Mr. Mueller's opinion, which lacks any evidentiary support. Helper crews are like any other T&E crews, and are subject to being on duty for 12 hours at a time (subject to obtaining their required rest). BNSF has accepted 270 shifts per year for road T&E crews. Mr. Reistrup further notes that switch crews do not have to travel to an away-from-home terminal and can easily work 270 shifts per year. Mr. Reistrup recalls that when he was an operating officer at the Baltimore & Ohio Railroad, yard crews routinely worked 16 hours a day (the Hours of Service Law then permitted operating employees to be on duty for 16 hours a day, as opposed to 12 hours today). His more recent experience at the Illinois Central and CSXT is that yard crews routinely work 12-hour shifts as this enables them to maximize their income.

Crew Hauler/Utility Clerk. BNSF proposes to include a crew hauler/utility clerk position at Alliance, with five employees to man this position 24/7. The only stated justification for this position is as follows: "The main duties assigned to this position involve transporting train crews and hostlers within the Alliance Yard . . . When the utility clerks are not being utilized to transport train crews and hostlers they will be available to provide administrative duties . . ." See BNSF Reply at III.D-20 to 30. Mr. Reistrup disagrees that a crew hauler/utility clerk position is needed at Alliance. As

indicated below, the TNR does not need hostlers at Alliance. Train crew members can drive themselves between their locomotive and the on/off-duty point in the yard, using a company vehicle. The crew hauler position is a vestige of Class I work rules with their rigid craft lines. T&E personnel routinely drive themselves between locomotive and on/off duty point on non-unionized railroads and there is no reason why the TNR cannot use the same procedure.

Hostlers. BNSF proposes to add three two-man hostler crews, working 24/7 in eight-hour shifts at Alliance to handle locomotives. A total of 24 employees would be required to staff these positions as envisaged by BNSF. See BNSF Reply at III.D-20. Mr. Reistrup disagrees that locomotive hostlers are needed at Alliance Yard, and even if they were needed, Mr. Reistrup is completely mystified as to why BNSF has proposed two-person hostler crews rather than a one-person crew.²³

BNSF's explanation for the added hostler positions is that hostlers "are required to move locomotives from both the front of the train and the DP position to and from the service tracks." BNSF also asserts that "BNSF crews delivering empty trains to the TNR in interchange cannot be required to detach their locomotives from the train and move them to the service area, therefore, the hostlers will be required to perform that task on each empty [train] received in interchange." BNSF Reply at III.D-20. Hostlers are a

²³ BNSF has provided no justification whatsoever for two-person hostler crews.

vestige of old rail union work rules.²⁴ They may be required to move locomotives between trains and fueling/servicing yard sites on BNSF under its collective bargaining agreements, but they are not required for efficient operations by a non-unionized railroad such as the TNR.

Mr. Reistrup notes that the locomotives on loaded trains are not detached at Alliance, but run through that point with their train – therefore there is no need to move locomotives between loaded trains and the fueling/servicing facilities. With respect to empty trains arriving at Alliance from the south via the TNR, there is no reason why the inbound train crew cannot detach the lead locomotives and move them to the fueling/servicing facilities before going off duty, unless they are out of time under the 12-hour law in which event an employee of the locomotive fueling/servicing contractor can move the locomotives.²⁵ One of the TNR switch locomotives at Alliance can also perform this function as they are not always busy switching bad-order cars and spares (*e.g.*, a switch

²⁴ Mr. Reistrup recalls that when he was with RL Banks & Associates in the early 1980's he participated in a study for the Commonwealth of Pennsylvania of the feasibility of replacing conventional rail passenger service between Philadelphia and Pittsburgh with a "magnetic levitation" (MAGLEV) system. The engineering firm engaged to plan the facilities and their operation had several former railroad personnel on the project and the firm's plan included hostlers to move the MAGLEV trains between the first or last station on their daily runs and the repair/servicing shop. Mr. Reistrup pointed out the absurdity of this and the hostlers were promptly removed. (The Pennsylvania MAGLEV plan, of course, never came to fruition.)

²⁵ Maintenance personnel can move locomotives within yards so long as they do not operate on the main line. Mr. Reistrup has found it useful to use maintenance personnel to move locomotives between trains and maintenance facilities because they spot potential problems that the engineer may not have noticed or reported.

locomotive will often be idle while waiting for a 1,500-mile inspection of a train to be completed). Contractor employees (or a TNR switch locomotive) will also detach the rear DP unit and move it to the servicing facilities. On outbound empty trains, the TNR train crews will normally move the lead locomotives from the fueling/servicing facilities to the train while a contractor employee will move the DP unit to the train – although an otherwise-idle TNR switch locomotive can also be used for this purpose.

With respect to empty trains received in interchange from BNSF at Alliance, BNSF does not explain why the inbound BNSF crew “cannot be required” to detach the lead locomotives and take them to the fueling/servicing area. But even if this is true, a TNR contractor employee or a TNR switch engine can perform this function – as well as the removal of the DP unit on the rear of the train.

ii. Mine Loading Costs/Taxi & Overnight Expenses

BNSF correctly notes that AEP Texas neglected to include costs for the contractors who move TNR trains through the PRB mine loading facilities.²⁶ BNSF Reply at III.D-24 to 25. On Rebuttal, AEP Texas has included these costs at the same level provided by BNSF, applied to the higher train counts used by AEP Texas and applied to only those mine origins where they are applicable.

²⁶ As discussed at p. III-B-13 to 14, *supra*, the TNR uses a loading contractor only at certain mines served by the Orin Subdivision and Reno Branch. It does not use a loading contractor at mines on the Campbell Branch.

In BNSF's Reply electronic workpaper file "LUMs and Carmiles (AEPTX-BNSF).xls," Sheet "Load Fees," BNSF determines the tons to which the third party loading fees apply. However, these tons include { } million tons from five origins that are designated by BNSF as having no loading-fee cost per ton. On Rebuttal, AEP Texas has accepted BNSF's loading-fee cost per ton but has not applied it to trains originating at these five origins. In addition, AEP Texas does not apply loading fees to mines located on the Campbell Branch because the TNR train crews will accompany the trains through the loading process at those mines. *See* pp. III-B-13 to 14, *supra*. This is consistent with *TMPA*, where the Board determined that contractor loading fees are not required where the SARR's train crews could provide the service. *Id.* at 110.

Finally, BNSF states at p. III.D-25 of its Reply that {

} *See* AEP Texas Reb.

electronic workpaper file "TNR Loading Fees_Rebut.xls."

BNSF generally agrees with AEP Texas' assumptions concerning when taxis and crew overnights would be required. BNSF Reply at III.D-25. AEP Texas also agrees with BNSF that crews on overnight stays should not be required to share a hotel room (*id.*), and has increased the TNR's overnight expenses accordingly. *See* AEP Texas Reb. electronic workpaper file "TNR Operating Statistics_Rebuttal.xls."

iii. Operating Personnel Compensation

On Opening, AEP Texas based the wage rates for TNR operating personnel on the actual comparable BNSF employees' compensation in 2000. TNR operating personnel wages were developed using the BNSF Wage Forms A and B, applied to the job title classifications in 49 C.F.R. Chapter X, § 1245.5. AEP Texas indexed the annual compensation to 2Q00 wage levels for use in the DCF model. AEP Texas also applied a 33.9 percent fringe benefit rate to the combination of base wages, overtime and constructive allowances. BNSF objects to both AEP Texas' method of indexing the wage rates and to the fringe benefit ratio AEP Texas applied to the wage rates. The only difference in the wage rates used by AEP Texas and BNSF for non-train crew operating personnel relate to these two issues. For train crews, BNSF also objects to both the wage rates and the constructive allowances used by AEP Texas to develop crew wages.

(a) Wage Rate Indexing Methodology

On Opening, AEP Texas indexed annual 2000 wages to the 2Q00 wage and price levels using the relationship between the AAR second quarter wage index to the AAR Western Region annual wage rates index. In contrast, BNSF indexed 2000 wage rates based on the relationship between the AAR second quarter wage index and the average of the wage index of each of the four quarters of 2000. In *PSCo/Xcel*, the Board rejected the approach used by AEP Texas in Opening in favor of BNSF's approach. *Id.* at 71. On Rebuttal, AEP Texas has used the approach accepted in *PSCo/Xcel*.

(b) Fringe Benefits

AEP Texas calculated its fringe benefit rate of 33.9 percent from the ratio of supplements to wages for all Class I carriers found in the 2Q00 calculation of the RCAF. On Reply, BNSF objects to the use of this fringe benefit ratio, claiming that it is far less than that paid by Class I railroads and less than that accepted by the Board in *TMPA*. See BNSF Reply at III.D-26. BNSF derived a three year average fringe benefit ratio reported for Class I railroads with annual revenues less than \$1.0 billion, thus producing a fringe benefit rate of 43.4 percent. *Id.* at III.D-27.

BNSF's fringe benefit rate is excessive and improper for the TNR. As an initial matter, BNSF's three-year average is composed of data for a varying group of railroads. In particular, although significantly lower fringe benefit levels were paid by some of the large carriers during each of the three years selected by BNSF for its analysis, BNSF elected to utilize much higher fringe benefit ratios and in certain instances, to vary – on a year-to-year basis – the group upon which its average was based.

BNSF's own workpaper reveals that the "least cost" fringe benefit ratio was far lower than the 33.9% fringe benefit ratio submitted on Opening by AEP Texas. For example, according to BNSF's workpapers NS' transportation department fringe benefit ratio was 31.3 percent, 24.4 percent and 36.1 percent for 2000, 2001 and 2002, respectively. This produces a three-year average of 30.6 percent, or less than that used by AEP Texas. Further, BNSF's data also shows that in 2000, the TNR's base year, UP, NS

and KCS had fringe benefit ratios of 32.5 percent, 31.3 percent and 33.8 percent, respectively – each lower than AEP Texas’ ratio of 33.9 percent. BNSF’s claim that the amount used by AEP Texas is less than that paid by Class I railroads is incorrect.

Moreover, BNSF fails to point out that three of the four carriers it includes in its calculation are wholly-owned subsidiaries of much larger carriers whose revenues exceed the \$1.0 billion threshold set by BNSF. These carriers are Soo (owned by CP) and IC and GTW (both owned by CN). This leaves only the KCS as a carrier with revenues truly below \$1.0 billion. KCS’s G&A fringe benefit ratios for the three years selected by BNSF range from 33.8 percent to 41.6 percent with a three year average of 38.8 percent for the period.

Finally, BNSF’s use of a multiple-year average fringe benefit ratio is inappropriate because the DCF model increases base year expenses quarterly by the change in the RCAF. As the RCAF includes a wages and supplements (*i.e.*, fringe benefits) component, the impact of changes in fringe benefits in years beyond the base year is reflected in the application of the RCAF to the base year operating expenses. Were the Board to use only the base year 2000 fringe benefit ratio for carriers whose organizations truly have revenues less than \$1.0 billion, KCS would be the only qualifying carrier. Based on BNSF’s workpapers, KCS’s transportation department fringe benefit ratio for 2000 was 33.8 percent or virtually the same as that used by AEP Texas.

In light of the irregularities in BNSF's analysis of supposedly representative fringe benefit ratios, AEP Texas continues to use the 33.9 percent fringe benefit ratio that it calculated from AAR data in its Opening evidence.

(c) Train Crew Compensation

On Opening, AEP Texas based train crew compensation on average straight time and overtime compensation as found in BNSF's Wage Forms A and B, increased to reflect constructive allowances that the TNR would pay for vacations, meals and other appropriate constructive allowances. The constructive allowances included by AEP Texas adds { } percent to straight time plus overtime wages paid to TNR's crews. AEP Texas calculated separate wages for each of the TNR's conductors and engineers and then averaged the two to develop a wage rate of { } to apply to all train crew members.

On Reply, BNSF claims that AEP Texas' crew compensation levels would be infeasible and that the TNR would only be able to hire qualified conductors and engineers to work 270 shifts per year by paying them an annual salary of { }. Both claims are addressed below.

Wage rates. BNSF based its wages rates on the 2000 salaries of { } conductors and { } engineers who worked between { } shifts per year in 2002. This data was taken from BNSF crew wage data for employees working on trains in the TNR territory. In its narrative, BNSF devotes extensive verbiage to describing how

hard it would be for train crews to work 270 shifts and how the TNR would have to pay extra-high salaries for these extremely motivated employees to work that many shifts. However, examination of the data reveals that the number of shifts is not the source of the difference between the parties at all. Rather, as shown in Table III-D-14 below, the payment of constructive allowances accounts for nearly the entire difference.

In fact, Table III-D-14 shows BNSF’s presumed straight time and overtime amount is actually less than that used by AEP Texas in Opening, by { } or { } percent, while the constructive allowances paid exceed the amount in AEP Texas’ Opening by { }, or { } percent.

TABLE III-D-14 <u>Comparison of Average T&E Compensation</u>			
Item	AEP Texas Opening	BNSF Reply	Difference
1. Straight time	{ }	{ }	{ }
2. Overtime	{ }	{ }	{ }
3. Straight time plus overtime	{ }	{ }	{ }
4. Constructive allowances	{ }	{ }	{ }
5. Total	{ }	{ }	{ }
Source: AEP Texas Reb. electronic workpaper file “Analyze BNSF Wages.xls.”			

BNSF attempts to justify its high levels of compensation by creating the impression that the labor market for railroad employees is a “seller’s market” and that the TNR would have to pay high levels of compensation to compete with UP and BNSF.

This impression of a sellers market is far from accurate, especially in 2000 when the TNR begins operations. The Bureau of Labor Statistics' (BLS) *Occupational Outlook* says of railroad employment: "Overall employment in the railroad transportation industry is expected to decline due to productivity gains." The BLS goes on to explain that:

Competition for available opportunities is expected to be keen. Many persons qualify for rail transportation occupations because education beyond high school is generally not required. Many more desire employment than can be hired because the pay is good and the work steady. Employment for a majority of railroad transportation occupations is expected to decline through the year 2010 with only locomotive engineers expected to grow.^[27]

BNSF's image of intense competition for qualified rail labor is inconsistent with these findings by the BLS.

Moreover, BNSF implication that there is intense competition for rail labor is in conflict with the fact that in early 2000, when the TNR begins service, BNSF was laying off train crews as it had a surplus of experienced engineers and conductors.²⁸

Constructive Allowances. BNSF states that AEP Texas' exclusion of certain constructive allowances is improper for four reasons. First, BNSF claims that constructive allowances are merely an accounting mechanism used to categorize total compensation received by T&E employees and AEP Texas has not explained why the TNR employees would be willing to forego the compensation that they would earn at

²⁷ See AEP Texas Reb. Workpapers Vol. 2, pp. 00624-626.

²⁸ See AEP Texas Reb. Workpapers Vol. 2, pp. 00617-623.

another railroad. Second, BNSF claims that AEP Texas excluded several constructive allowances for clearly legitimate activities (thus seemingly agreeing with AEP Texas that there are other constructive allowances paid to T&E employees that are not for legitimate activities), such as ongoing training, military service and safety meetings. Third, BNSF claims that AEP Texas has failed to provide any basis for the proposition that the TNR would be non-union and therefore not subject to union work rules and pay scales. Finally, BNSF claims that the constructive allowances paid by the Wisconsin Central (“WCS”) to its newly unionized T&E employees is not a valid comparison and that the crews on the WCS do not work 270 shifts per year as AEP Texas proposes for the TNR.

BNSF is incorrect in asserting that the TNR T&E employees would not forego wages they could earn at other railroads. As reported in the article entitled “A Different Way to Run a Railroad: Regional Versus National Carriers,” train and engine personnel with regional companies tend to have lower compensation levels, estimated to be 15 to 20 percent less than that paid by the Class I carriers.²⁹ The compensation paid by the TNR to its crews is { } percent of that paid by BNSF to its crews.

Moreover, a recent filing by the Iowa, Chicago & Eastern Railroad (ICE) demonstrates that AEP Texas’ proposed T&E wages are feasible. As part of its proposed acquisition of the I&M Rail Link (IMRL), the ICE posted a notice at the workplace of all

²⁹ The cited article, by Tom Murray, was published in the Journal of Transportation Law, Logistics and Policy, Spring 2004, Volume 71, Number 3.

rail employees that listed wage rates at which the ICE would rehire IMRL employees. This notice was filed with the Board on May 28, 2002. The rates listed for train crews range from \$107.58 to \$161.36 per day.³⁰ At 270 starts per year, this would translate into a range of \$29,047 to \$43,567 per year with the middle of the range at \$36,307. Even if one assumed, as BNSF does, that TNR crews would be paid BNSF's constructive allowances and overtime equal to { } percent of base salary, the resulting salary using average IMRL wage rates would be { }, which is less than the { } included by AEP Texas for the TNR employees.

The IMRL operates between Chicago, Kansas City and Minneapolis/St. Paul, where it competes with both the Union Pacific and BNSF for qualified train crews. It faces as much or more competition for labor from Class I carriers as would the TNR. The IMRL example demonstrates that BNSF's proposed T&E wages for the TNR cannot be justified.

Finally, the TNR is not the BNSF, and TNR would not pay all of the same constructive allowances that are a result of BNSF's union legacy. For example, two of the largest constructive allowances have to do with "short crews." One is the Special Pay Differential, which the Brotherhood of Locomotive Engineers negotiated when the U.S. Congress enacted legislation in 1991 that forced a reduction in crew consists. The United Transportation Union similarly negotiated the other short crew allowance, the Reduced

³⁰ See AEP Texas Reb. electronic workpaper file "IMRL_Notice.pdf."

Crew Allowance. Neither of these would be applicable to the TNR, because it would start with two-person crew consists as a standard. Further, BNSF has accepted the two-person crew concept for the TNR and cannot claim that it a two-person crew is a “short crew” for constructive allowance purposes. Even railroads that are unionized do not necessarily pay these constructive allowances. For example, a 1998 agreement between the United Transportation Union and WCS includes several constructive allowances, but does not include short crew allowances.³¹ Other union-related constructive allowances that are irrelevant to the TNR include Deadheading, Guarantee, and Held Away from Home. BNSF asserts that AEP Texas has not made a valid comparison between the TNR and WCS, and that what the WCS negotiated with its unions is not relevant here. However, the WCS experience is consistent with that reported by Mr. Murray in the previously cited article indicating that regional railroads pay their T&E employees 15 to 20 percent less than the wages paid by the Class I carriers.³²

On Rebuttal, AEP Texas has adjusted its T&E wages to correct for indexing from annual 2000 wage levels to 2Q00 wage levels. Table III-D-15 below compares the parties’ train crew wages.

³¹ See AEP Texas Op. Workpapers Vol. 18, pp. 08966-8986.

³² AEP Texas notes that, notwithstanding BNSF’s trashing of comparisons with WCS here, BNSF frequently draws comparisons between the TNR and WCS in its discussion of General and Administrative expense.

TABLE III-D-15 Comparison of T&E Compensation for the TNR				
Item	AEP Texas Opening	BNSF Reply	AEP Texas Rebuttal	Difference (BNSF Reply - AEP Texas Rebuttal)
Compensation per employee	{ }	{ }	{ }	{ }
T&E Personnel	514	515	528	(13)
Total T&E Compensation	{ }	{ }	{ }	{ }

iv. Materials, Supplies & Equipment - Operating

On Reply, BNSF has included \$2,275,181 for operating personnel materials, supplies and equipment compared to \$1,151,124 included by AEP Texas on Opening. BNSF indicates that it accepts many of AEP Texas' material, supplies and equipment unit costs. However, BNSF claims that AEP Texas safety equipment costs are unacceptably low and that it calculates more appropriate safety gear costs for trainmen and equipment inspectors. BNSF states that it also adds travel expense equal to five percent of non-train operating personnel salaries. *See* BNSF Reply at III.D-33.

BNSF's proposed purchase of Dodge Dakota pickups for the TNR's car-inspection crews is also a mystery. On Opening, AEP Texas assumed that equipment inspectors would use utility carts to inspect trains. This is common practice in the railroad industry. The utility carts are gas-powered vehicles that resemble oversized golf carts and are the most appropriate vehicles for slowly moving along-side trains being

inspected. BNSF accepts AEP Texas' use of these utility carts, but also equips inspectors with pickup trucks, creating yet another double count in expenses. What the inspection crews would do with the pickup trucks is left to the imagination.

BNSF's payment calculation also includes a bizarre twist in that it counts the automobile salvage value as a cash outflow. BNSF's depreciation tables include a 13 percent positive salvage value for automobiles, but BNSF's calculation treats this amount as a negative salvage, thus increasing the TNR's annual payments.

BNSF also disagrees with AEP Texas' estimate for safety equipment of \$16.46 per train crew employee and \$24.13 for equipment inspectors. BNSF outfits TNR employees with a variety of clothing and safety gear, including not only hard hats, reflective vests and belts and protective eye wear; but also cold and warm weather boots, cold and warm weather gloves and prescription eye wear. BNSF includes \$240.81 per year for safety equipment for each T&E employee and \$287.35 per year for safety equipment for each equipment inspector.

According to AEP Texas' experts, railroads do not typically supply employees with clothing items such as boots and gloves. Employees supply these items themselves. Furthermore, expensive prescription eye wear would be unnecessary because plano glasses fit over employees' own prescription glasses. AEP Texas continues to use \$16.46 per T&E employee and \$24.13 per equipment inspector per year for safety equipment in its Rebuttal evidence.

BNSF also includes in its materials and supply operating expense an amount of \$616,980 for travel expenses. According to BNSF's workpapers, this amount equals five percent of annual compensation for all operations and mechanical staff. BNSF provides no explanation as to the source of the five percent or why it should be applied to all staff members. AEP Texas also includes an amount for employee travel, but considerably less (\$16,000). AEP Texas assumes that each employee of Manager level or above would be granted a travel budget. The cost per employee is based upon a survey by Runzheimer International, which found that the average travel cost per corporate business traveler was \$8,000 in 2000.³³ Operating personnel of Manager and below would already have access to company vehicles for local travel. BNSF's estimate is unsupported and should be rejected.

b. Non-Operating

i. Staffing

Non-Operating employees include Mechanical and Engineering/maintenance-of-way personnel. On Opening, AEP Texas included these personnel as Operating employees but for ease of comparison with BNSF's staffing proposal treats them as Non-Operating employees for purposes of its Rebuttal discussion.

³³ See AEP Texas Op. Workpapers Vol. 18, p. 09072.

The parties' Non-Operating Mechanical personnel for the TNR are shown in Table III-D-16 below. Engineering personnel are discussed *infra* in Part III-D-below in Part III-D-3-c (G&A expenses) and III-D-4 (maintenance-of-way expenses).

TABLE III-D-16 TNR Mechanical Personnel - 2000				
Position	AEP Texas/ Opening	BNSF/ Reply	AEP Texas/ Rebuttal	Difference (Reb. v. Reply)
Director of Mechanical Services ^{1/}	1	1	1	0
Manager of Mechanical Operations	2	2	2	0
Equipment Inspectors	106	108	108	0
Total	109	111	111	0
^{1/} AEP Texas includes this position in the TNR's G&A staff; it is shown here only for convenience of comparison between the parties' proposed Mechanical staffing.				

Both parties agree that the TNR needs a Director of Mechanical services. On Opening, AEP Texas included this position in the TNR's G&A staffing; BNSF proposes to include it in the Non-Operating (Mechanical) staff. AEP Texas believes this position is more appropriately treated as part of the G&A staff (the same is true of the Manager of Testing/Environmental, an Engineering employee that BNSF proposes to move from G&A to Operating).³⁴ Otherwise, under BNSF's G&A staffing proposal, only

³⁴ See the portion of Table III.D-7 on page III.D-63 of BNSF's Reply Narrative. BNSF's nomenclature is confusing and inconsistent; in the table it describes these positions as "In Operating" but in fact it treats them as Non-Operating rather than

(continued...)

two employees would report to the Vice President-Engineering and Mechanical (three including the Chief Engineer), one of whom would be an administrative assistant. *See* BNSF Reply at III.D-63, portion of Table III.D-7. This is an absurdly top-heavy organization.

With respect to equipment inspectors, AEP Texas agrees with BNSF's conversion factor to develop the number of employees required to staff six four-person inspection crews on a 24/7 basis. *See* BNSF Reply at III.D-33 to 34. Accordingly, AEP Texas has increased the number of employees needed to fully staff these positions by two employees, increasing the total from 106 to 108.

With the change in the number of equipment inspectors, the parties are now in complete agreement as to the required Mechanical staffing for the TNR (regardless of whether they are treated as Non-Operating or G&A employees).

ii. Compensation

The difference in the parties' salaries for mechanical department personnel is due to the difference in the methodology used to index year 2000 wages to 2Q00 wage levels. As discussed with regard to salaries for Operating personnel, on Opening AEP Texas indexed wages annual 2000 wages to the 2Q00 wage and price levels using the relationship between the AAR second quarter wage index to the AAR Western Region

³⁴ (...continued)

Operating employees. This is a matter of form over substance as the parties agree that both positions are needed.

annual wage rates index. In contrast, BNSF indexed 2000 wage rates based on the relationship between the AAR second quarter wage index and the average of the wage index of each of the four quarters of 2000. In *PSCo/Xcel*, the Board rejected the approach used by AEP Texas on Opening in favor of BNSF's approach. *See PSCo/Xcel* at 71. On Rebuttal, AEP Texas has used the approach accepted in *PSCo/Xcel*. Otherwise, the parties agree on both the staffing and the salaries for the mechanical department personnel.

c. General and Administrative

On Opening, AEP Texas included \$12.9 million for G&A costs, including costs related to personnel, materials and supplies, and the outsourcing of various activities. AEP Texas' Opening Evidence organized the TNR's 56 G&A personnel into a President's Office and four separate Departments responsible for the railroad's principal staff functions. *See* AEP Texas Op. at III-D-26 to 27.³⁵ Those included a Transportation Department (which also is responsible for the customer service and marketing functions), an Engineering and Mechanical Department, a Finance/Accounting Department, and a Legal Department (which also is responsible for human resource functions).

³⁵ AEP Texas also has determined that it will add three additional employees to its G&A staffing on Rebuttal. However, AEP Texas continues to support a total G&A staff of 56 employees because three Transportation Dept. employees AEP Texas included as G&A staff on Opening have been moved to the Operating staff on Rebuttal.

In its Reply Evidence, BNSF argues that 2001 G&A expenses for the TNR should be increased to a level that is 223% of AEP Texas' estimate (*i.e.*, \$28.8 million). The \$15.9 million disparity between the parties' estimates amounts to 15% of the total 2001 operating cost difference between the parties' Opening and Reply evidence, and after maintenance-of-way (a \$37.1 million disparity), constitutes the second largest operating cost dispute between the parties.

The vast majority of the difference in the parties' evidence regarding G&A staffing levels relates to BNSF's inclusion of an excessive number of employees in the Finance and Accounting Department (32 additional employees) and the Law and Administration Department (ten additional employees), and to BNSF's creation of a new and over-staffed Marketing Department (seven additional employees). Additional differences also exist between the parties with respect to the cost of materials and supplies and the costs associated with outsourcing. Finally, there are significant differences between the parties regarding the amount and proper accounting treatment of start-up costs.

Summary of Rebuttal Evidence

AEP Texas rejects the management reconfiguration, additional staffing, and additional compensation proposed by BNSF for the TNR and continues to reply upon the evidence that it submitted on Opening, with the exception of the following items:

- (1) Consistent with the Board's decision in *TMPA* (at 94 n.158), AEP Texas is relocating three positions (*i.e.*, Director of Operations

Control, Director of Train and Locomotive Operations, and Manager of Operating Rules and Safety) from the G&A staff to the Operating staff;³⁶

- (2) AEP Texas accepts BNSF's recommendation that the TNR's Board of Directors should include the Vice President–Finance rather than the Vice President– Transportation;
- (3) AEP Texas accepts BNSF's proposal to add a Payroll Manager to the Finance and Accounting Department;
- (4) AEP Texas accepts BNSF's argument that an additional Finance and Accounting staff member is required with respect to Equipment Accounting and Miscellaneous Billing (although AEP Texas submits that only one additional position – rather than two – would be required to perform this work);
- (5) AEP Texas accepts BNSF's proposal to add a Manager of Purchasing to the Finance and Accounting Department;
- (6) AEP Texas accepts the Board's Decision in *PSCo/Xcel* related to the indexing of BNSF 2000 wages to 2Q00 wage and price levels;
- (7) AEP Texas accepts BNSF's assignment of USOA classification codes for certain G&A employee positions; and
- (8) AEP Texas adjusts the TNR's recruiting and training costs in several minor respects to reflect valid BNSF criticisms as well as the Board's recent decision in the *PSCo/Xcel* case.

Table III-D-17 below compares the parties' evidence regarding G&A staffing levels for the TNR.

³⁶ Unlike BNSF, AEP Texas will not relocate: (i) the Director of Customer Service; (ii) the eight Customer Service Managers; (iii) the Director of Mechanical Services; or (iv) the Manager of Testing/Environmental.

TABLE III-D-17
Comparison of G&A Evidence
Submitted by AEP Texas and BNSF

Position	AEP Texas Opening	BNSF Staffing (Narrative) ^{1/}	AEP Texas Rebuttal	Difference (BNSF Reply - AEP Texas Reb.)
President's Office				
President/CEO	1	1	1	0
Director of Corp. Relations	1	1	1	0
Administrative Assistant	1	1	1	0
President's Office Total	3	3	3	0
Transportation Department				
<i>1. Executive Function</i>				
V.P.-Transportation	1	1	1	0
Administrative Assistant	0	1	0	1
Secretary	0	1	0	1
Dir. of Operations Control	1	0	0	0
Dir. Train/Loco. Operations	1	0	0	0
Mgr. Operating Rules/Safety	1	0	0	0
<i>Subtotal</i>	4	3	1	2
<i>2. Customer Service and Marketing Functions^{1/}</i>				
Dir. Customer Service	1	0	1	(1)
Customer Service Mgrs.	8	0	8	(8)
V.P. Marketing	0	1	0	1
Asst. V.P.-Coal Marketing	0	1	0	1
Manager-Coal Marketing	2	2	2	0
Market Mgr.-Other	0	4	0	4
Secretary	0	1	0	1
<i>Subtotal</i>	11	9	11	(2)
Transportation Dept. Total	15	12	12	0
Engineering and Mechanical Department				
V.P. Engineering/Mechanical	1	1	1	0
Dir. Mechanical Services	1	0	1	(1)
Mgr. Budgets/Purchasing	1	0	1	(1)
Mgr. Testing/Environmental	1	0	1	(1)
Clerk	1	1	1	0
Administrative Assistant	0	1	0	1
Eng./Mech. Dept. Total	5	3	5	(2)
^{1/} AEP Texas and BNSF agree that the TNR should have a Director of Customer Service and eight Customer Service Managers. However, BNSF assigns these employees to Operating Personnel whereas AEP Texas retains them as G&A personnel. See Table III.D.3-1 on page III.D-19 of BNSF's Reply Narrative.				

TABLE III-D-17 (continued)
Comparison of G&A Evidence
Submitted by AEP Texas and BNSF

Position	AEP Texas Opening	BNSF Staffing (Narrative)	AEP Texas Rebuttal	Difference (BNSF Reply - AEP Texas Reb.)
Finance and Accounting^{2/}				
1. Executive/Treasury Function				
Vice President (& Treasurer)	1	1	1	0
Secretary	0	1	0	1
Assistant V.P.-Treasurer	0	1	0	1
Assistant Treasurer	0	1	0	1
Manager of Administration	1	0	1	(1)
Cash Manager	0	2	0	2
<i>Subtotal</i>	2	6	2	4
2. Controller Function				
Controller	1	1	1	0
Asst. Controller-Revenue	1	0	1	(1)
Asst. Controller-Disbursements	1	0	1	(1)
Revenue Accounting Manager	0	1	0	1
Clerks	2	6	2	4
Disbursements Manager	0	1	0	1
Disbursements Clerks	0	2	0	2
<i>Subtotal</i>	5	11	5	6
3. Payroll Function				
Payroll Manager	0	1	1	0
Payroll Coordinator	0	1	0	1
<i>Subtotal</i>	0	2	1	1
4. Tax Function				
Director of Taxes	1	1	1	0
5. Financial Reporting Function				
Manager-Financial Reporting	1	0	1	(1)
Seven unspecified individuals (see BNSF Reply at III.D-74)	0	7	0	7
<i>Subtotal</i>	1	7	1	6
6. Revenue Analysis/Budgeting Function				
Manager-Revenue Analysis	0	1	0	1
Dir.-Budgeting and Analysis	1	0	1	(1)
Analyst	0	1	0	1
<i>Subtotal</i>	1	2	1	1

^{2/} As discussed in greater detail, *infra*, BNSF's narrative description of the Finance and Accounting Department is inconsistent with the G&A Chart on pp. III.D-61 to 62 of its Reply Narrative and with BNSF's actual costs. This Table is based upon the positions actually described by BNSF in its narrative. BNSF includes costs for four additional positions.

TABLE III-D-17 (continued)
Comparison of G&A Evidence
Submitted by AEP Texas and BNSF

Position	AEP Texas Opening	BNSF Staffing (Narrative)	AEP Texas Rebuttal	Difference (BNSF Reply - AEP Texas Reb.)
7. Equipment Accounting/Misc. Billing Function				
Mgr. Car Equipment Accounting	0	1	0	1
Manager Misc. Billing	0	1	0	1
Manager of AAR Billing	0	0	1	(1)
<i>Subtotal</i>	0	2	1	1
8. Internal Audit Function				
Director-Internal Audit	0	1	0	1
9. Real Estate Function				
Director of Real Estate	0	1	0	1
Manager of Real Estate	0	1	0	1
<i>Subtotal</i>	0	2	0	2
10. Purchasing Function				
Director of Purchasing	0	1	0	1
Manager of Purchasing	0	2	1	1
<i>Subtotal</i>	0	3	1	2
11. IT Function				
Assistant V.P.-IT	0	1	0	1
Director-IT	1	1	1	0
IT Specialists	10	10	10	0
<i>Subtotal</i>	11	12	11	1
Finance/Accounting Total	21	49	24	25
Law and Administration				
1. Legal Function				
V.P. Law and Administration	1	1	1	0
General Attorneys	2	2	2	0
<i>Subtotal</i>	3	3	3	0
2. Safety/Claims Function				
Asst. V.P.-Safety/Claims	0	1	0	1
Dir. Safety/Claims	1	1	1	0
Managers of Safety	2	3	2	1
<i>Subtotal</i>	3	5	3	2

TABLE III-D-17 (continued)
Comparison of G&A Evidence
Submitted by AEP Texas and BNSF

Position	AEP Texas Opening	BNSF Staffing (Narrative)	AEP Texas Rebuttal	Difference (BNSF Reply - AEP Texas Reb.)
<i>3. Human Capital Function</i>				
Asst. V.P.-Human Capital	0	1	0	1
Dir. of Human Capital	1	3	1	2
Analyst	0	1	0	1
H.R. Coordinators	0	4	0	4
Manager of Training	1	1	1	0
Asst. Managers of Training	0	2	0	2
<i>Subtotal</i>	2	12	2	10
<i>4. Secretarial Pool/Law & Admin. Secretaries</i>				
Secretaries	4	2	4	(2)
Law/Admin. Department Total	12	22	12	10
G&A TOTAL STAFFING	56	89	56	33
(Employees Moved from G&A)	N/A	14	3	11
Note: AEP Texas has reassigned three G&A employees to the Operating Department and has accepted BNSF's addition of three new G&A staff members, thus resulting in no net change in the total G&A staffing of the TNR.				

The overall G&A budget estimates provided by the parties, including G&A compensation, outsourcing, and materials and supplies, are as follows:

AEP Texas Opening –	\$12.9 million
BNSF Reply –	\$28.8 million
AEP Texas Rebuttal –	\$13.1 million

See AEP Texas Reb. electronic workpaper file “TNR_OP_Exp_Rebut.xls.” AEP Texas’ Rebuttal costs reflect the fact that three Opening G&A positions have been reassigned to Operating personnel while three other G&A positions have been added.

Evidentiary Basis for AEP Texas' G&A Expenses

In each of its recent decisions in *Duke/NS*, *Duke/CSXT*, and *Carolina*, the Board accepted the complainant's G&A expenses on the basis of its observation that the complainant's G&A staffing levels "are based on the experience of former senior-level railroad employees, [and] are reasonable and supported . . ." See *Duke/NS* at 73; *Duke/CSXT* at 59; *Carolina* at 61. Similarly, in its recent *PSCo/Xcel* decision, the Board characterized the complainant's evidence on G&A staffing levels as "feasible," as it was "supported by testimony from senior-level railroad employees." *Id.* at 66.

AEP Texas' G&A evidence likewise is sponsored by witnesses who have considerable expertise in matters relating to both operating and G&A expenses, and collectively have spent many years working for Class I and other railroads in positions of significant responsibility. AEP Texas' principal witness, Paul Reistrup, has over 45 years of experience in railroad operations, engineering, and management, largely with CSX Transportation, Inc. and its predecessors as well as the Illinois Central. Mr. Reistrup also has served as President of both the Monongahela Railway and Amtrak.³⁷ Moreover, AEP Texas Witnesses William L. Krestinski (30 years, mostly with the Canadian Pacific Rail System), and Alan J. Blackwell (24 years, for Union Pacific and Missouri Pacific), also

³⁷ Philip Burris, a Senior Vice President of L.E. Peabody & Associates, Inc. with more than 25 years of consulting experience with regard to railroad economics, assisted Mr. Reistrup in developing AEP Texas' Part III-D-3 evidence regarding compensation levels for G&A personnel, material and supplies expenses, and non-Operating personnel training and recruiting costs.

have considerable railroading experience. Along with Mr. Reistrup and Harvey Stone of Stone Consulting & Design, Inc., Messrs. Krestinski and Blackwell sponsor AEP Texas' G&A engineering staff and compensation. Finally, witness Joseph A. Kruzich, who sponsors AEP Texas' IT evidence, has 38 years of experience in railroad accounting, executive administration, and information technology, including service as the Vice President Telecommunications and Chief Information Officer of the Kansas City Southern Railway. In light of this wealth of real-world experience, AEP Texas' G&A evidence is well-supported and consistent with recent Board decisions.

BNSF's Peer Railroad Comparisons are Irrelevant

Much of BNSF's G&A Reply is dedicated to a comparison between the TNR and certain supposed "peer" railroads. In this regard, BNSF first purports to identify the peers of the TNR on the basis of: (i) annual revenues; (ii) the total number of employees (including operating, non-operating, and G&A employees); (iii) operating mileage; and (iv) annual carloads. On the basis of those four characteristics, BNSF concludes that the six "best real-world carriers with which to compare TNR" are "IC, KCS, Soo, GTW, FEC and WCS." *See* BNSF Reply at III.D-45. Of these, BNSF states that three (*i.e.*, KCS, WCS and IC) have "the most comparable operations." *Id.*

BNSF presents no explanation of why these three carriers' operations supposedly are "most comparable" to the TNR's. In fact, the operations of these carriers are not even remotely comparable to the operations of the TNR. The TNR handles only

trainload traffic, most of which is unit-train coal traffic. It serves only five local destinations (the Pawnee, Arapahoe, Comanche, Harrington, and Oklaunion power plants). Furthermore, since Pawnee, Arapahoe, and Comanche each are Xcel/PSCo generating stations, the TNR actually only provides destination service to three corporate entities (*i.e.*, Xcel/PSCo, SPS, and AEP Texas North). Each one of the three carriers cited by BNSF serves a multitude of origins and destinations and many customers.

Likewise, approximately 95% of the TNR's traffic is composed of unit-train coal traffic. The TNR originates and forwards most of this traffic to BNSF as well as two other carriers (UP and NKCR) in interline service for delivery to its ultimate destination. The balance of the TNR's traffic is overhead manifest traffic that moves in intact trainload service and as to which the TNR performs only a small percentage of the total movement. None of the "most comparable" railroads identified by BNSF has a traffic mix of this nature.

Moreover, the four characteristics that BNSF has used to perform its "peer" identification are not relevant to the question of G&A expenditures. No additional G&A-related work is required to transport a unit train of coal 1,400 miles than to transport that same unit train only 100 miles, yet BNSF's analysis bases many of its comparisons on expenditures per 1,000 GTMs. Similarly, no additional G&A-related work is required to transport a unit train of coal 1,400 miles than to provide 100 miles of local service for a merchandise train carrying a combination of cars from a group of different shippers. In

fact, since the coal train is billed as a single unit (in a continuously repeating cycle), far less work is needed to administer this type of “high-GTM” service. Nevertheless, BNSF regards the carrier providing long-haul unit train service as warranting far greater G&A expenditures than the carrier providing multi-shipper merchandise train service.

In any event, after identifying its set of three “most comparable” peers, BNSF jettisons that identification from its analysis and instead compares the TNR and a continuously shifting group of railroads with regard to: (i) operating ratio; (ii) revenue per overall employee (including all Operating, Non-Operating, and G&A employees); (iii) operating expense per ton mile; (iv) G&A expense per 1,000 GTMs; (v) G&A staff productivity; (vi) Accounting, Auditing & Finance expense per 1,000 GTMs; (vii) legal expenses as a percentage of revenue; (viii) sales and marketing expense per 1,000 GTMs; and (ix) G&A purchased services cost per 1,000 GTMs.

Close examination of the statistics cited by BNSF reveals that the railroads used by BNSF for its comparisons are far from uniform. On the contrary, these railroads themselves show dramatic variations in the benchmark statistics relied upon by BNSF.

For example:

- G&A expense per 1,000 gross ton-miles varies from \$0.64 (UP) to \$2.35 (NS);
- Productivity, measured in gross ton-miles per G&A employee, varies from 220 million (NS) to 458 million (BNSF);
- Accounting, auditing, and financial expense per 1,000 gross ton-miles varies from \$0.03 (NS) to \$0.22 (CSX);

- Legal expense as a percentage of revenue varies from 0.6% (UP) to 1.5% (KCS);
- Sales and marketing expense per 1,000 gross ton-miles varies from \$0.03 (NS) to \$0.16 (CSX); and
- G&A purchased services per 1,000 gross ton-miles vary from \$0.13 (UP) to \$1.55 (NS).³⁸

These large disparities demonstrate that actual G&A expenditures can vary by a wide margin even among real-world railroads with similar operating expenses and similar revenues.³⁹ Perhaps the most informative of these disparities is the difference in “productivity” per G&A employee. As the foregoing list demonstrates, BNSF shows far greater gross ton-miles per G&A employee (458 million) than NS (220 million). Relative to NS, of course, BNSF generates a far greater share of its gross ton-miles through unit-train coal service involving distances over 1,000 miles. The TNR replicates this most “productive” of BNSF’s railroad services but does not replicate the more G&A-intensive portions of BNSF’s traffic base. Consequently, the TNR should reflect even greater “productivity” than BNSF in terms of gross ton-miles per G&A employee.

³⁸ See BNSF Reply electronic workpaper “G&A Charts.xls,” tabs “Per GTM by Function,” “G&A Productivity,” “Finance Per GTM,” “Legal vs Rev BAR,” “Sales Mkting per GTM,” and “PS by Account.”

³⁹ Even if the Board were to compare the TNR to a real-world railroad (and as AEP Texas demonstrates, it should not), it would be imperative under SAC theory that the Board limit such comparisons to the most efficient of those real-world railroads. Contrary to BNSF’s assumption, there is absolutely no justification for comparing the TNR to an inefficient railroad (or even to an average of efficient and inefficient railroads) since SAC theory enables the SARR to be optimally efficient.

The absence of a comparable real-world peer, which is entirely plausible under SAC analysis, mandates a different approach to developing the TNR's G&A expenses than BNSF has advocated. A proper approach for developing G&A expenses for the TNR should specifically analyze the nature of the TNR's operations and the functions to be served by each G&A staff member. In that regard, the actual factors that most directly drive G&A expenses are:

- the type of service provided by the carrier (*e.g.*, unit-train or carload);
- the number of individual destinations served by the carrier;
- the number of different commodities transported by the carrier;
- whether the carrier is a publicly traded company; and
- the carrier's corporate history (*i.e.*, mergers) and history of labor relations that might have led to – or might even formally require – additional layers of management.

Each of these factors suggests a relatively low level of G&A staffing in the case of the TNR compared with real-world railroads.

Consistent with this service-based approach to the question of G&A staffing, it is worthwhile to compare the G&A expense levels that are incurred by the TNR with the G&A expense levels approved by the Board in other stand-alone cost cases (where the number of destinations served is comparable to those served by the TNR and where the share of revenue earned from unit-train coal service is comparable, as well). For example, the *West Texas Utilities* proceeding involved the predecessors in interest to

the parties in this case and a coal movement from the PRB to the same power plant. In *West Texas Utilities*, the Board found that a G&A staff of only 38 individuals “appears to provide sufficient administrative personnel to carry out all the functions normally expected of a large railroad.” *Id.* at 695 (emphasis added). The G&A staffing proposed by BNSF’s corporate predecessor Burlington Northern (“BN”) and accepted by the Board in *West Texas Utilities* was as follows:

<u>Position</u>	<u>Number</u>
President	1
Controller/VP Administration	1
Accounting Specialists	10
General Counsel	1
Marketing/Field Sales	2
Personnel	2
Safety Director	1
Director-Data Processing	1
Data-Processing Specialists	12
<u>Secretaries</u>	<u>7</u>
Total	38

Id., 1 S.T.B. at 694 n.126.

The difference between the BN-proposed staffing level in the predecessor *West Texas Utilities* case and the BNSF-proposed staffing level in the instant case is staggering. BN’s G&A staffing proposal in *West Texas Utilities* is far more similar to AEP Texas’ staffing of the TNR than to BNSF’s current proposal which adds layer upon layer of unnecessary management.

While BNSF attempts to dismiss the significance of the *West Texas Utilities* case (see BNSF Reply at III.D-37 n.68), close scrutiny – based on three of BNSF’s own preferred statistics – shows that AEP Texas’ staffing of the TNR is actually more conservative than the staffing of the WTRR (the SARR involved in that case):

TABLE III-D-18 Comparison of WTRR and TNR Railroads (in millions of dollars except as noted)			
Item	WTRR (STB)	TNR (AEP Texas Rebuttal)	Difference/ Ratio
First Full Year of Operations	1995	2001	—
Annual Revenues	\$433.4	\$767.3	\$333.9
Annual Operating Expenses	\$142.2	\$271.3	\$129.1
Route Miles	1,416.3	1,192	(224.3)
Non-coal traffic as a percentage of total traffic (in tons)	0%	0.5%	0.5%
G&A Staffing (No. of Employees)	38	56	18
G&A Expense	\$3.4	\$12.9	\$9.5
G&A Expense as a Percentage of Revenues*	0.78%	1.68%	2.2:1
G&A Expense as a Percentage of Total Operating Expenses*	2.39%	4.75%	2.0:1
G&A Expenditures per System Route Mile*	\$2,401/mile	\$10,822/mile	4.5:1
* Each of these statistics (i.e., revenues, operating expenses, and route miles) is a measure cited by BNSF in its Reply evidence as being relevant to the determination of proper G&A expenditures. Source: <i>West Texas Utilities</i> , 1 S.T.B. at 657, 683, 689-90, 694-95, 711.			

Since the Board issued its decision in the *West Texas Utilities* case, considerable technological progress has been made. In fact, the eight-year interval between the two cases has witnessed a remarkable proliferation of desktop computers, email, and cashless banking/electronic funds transfers – all of which enhance the productivity of the TNR’s employees relative to those of the WTRR. As such, it would be reasonable to expect lower G&A expenditures now than at the time of the *West Texas Utilities* case. Nevertheless, AEP Texas has provided for G&A expenditures at levels that are twice the level from the *West Texas Utilities* case in terms of G&A expense as a percentage of annual revenues and G&A expense as a percentage of annual operating costs, and AEP Texas has provided for G&A expenditures that are four and one-half times the level from the *West Texas Utilities* case in terms of G&A expense per system route-mile. Once again, each of these statistics (*i.e.*, relating G&A expenses to revenues, operating costs, and route miles) is a measure that BNSF utilizes in its Reply evidence.

Similarly, the TNR’s operations are comparable to those of the stand-alone railroad in the *TMPA* case. Both SARRs have routes extending from the PRB to Texas, both transport large volumes of PRB coal in unit train service, and both serve a limited number of local destinations.⁴⁰ The total G&A expense level for the GCRR (the SARR involved in *TMPA*) was \$13.38 million. *See TMPA* at 78. The G&A expenditures

⁴⁰ Notably, the TNR is 27% shorter than the WTRR. The WTRR had 1,629 route-miles (*see TMPA* at 67 n.106) compared with 1,192 route-miles for the TNR.

proposed by AEP Texas are entirely consistent with those accepted by the Board in *TMPA*.

The foregoing analysis alone should suffice for the Board to accept AEP Texas' proposed G&A staffing in this case rather than BNSF's. However, because of the Board's recent tendency in SAC rate cases to accept virtually every element of a defendant's evidence that the complainant does not specifically challenge on rebuttal, out of an abundance of caution AEP Texas responds below to BNSF's evidence concerning the specifics of the TNR's G&A staffing in all of its mind-boggling detail.

i. Staffing Requirements

(a) President's Office/Executive Department

The parties are largely in agreement regarding the staffing of the TNR's President's Office/Executive Department. Table III-D-18 below summarizes the parties' evidence regarding that staffing and demonstrates that the differences between the parties' staffing proposals each relate to the composition (and as will be discussed *infra*, the compensation) of the TNR's Board of Directors.

TABLE III-D-19
Comparison of AEP Texas and BNSF Staffing
of the TNR President's Office/Executive Department

Position	AEP Texas Staffing	BNSF Staffing	Difference
President/CEO	1	1	0
Director of Corporate Relations	1	1	0
Administrative Assistant	1	1	0
Compensated Outside Board Members ^{1/}	0	5	5
Non-compensated Outside Board Members ^{1/}	3	0	(3)
Total	3 (+3)	3 (+5)	0 (+2)
^{1/} Neither party includes outside board members in its total G&A staffing figure. The numbers in parentheses in the "Total" line represent differences in the numbers of outside board members. Source: AEP Op. at III-D-28 to 29; BNSF Reply at III.D-61.			

AEP Texas proposed a five-person board, composed of two members of the TNR's executive team (the President and Vice President–Transportation) and three outside board members who would serve on a voluntary basis as representatives of the TNR's customers and the financial community. *See* AEP Texas Op. at III-D-29. On Reply, BNSF proposes a seven-member board, with two "inside" directors and five outside directors.⁴¹

⁴¹ BNSF includes a fifth argument regarding Directors' and Officers' Insurance in the context of its discussion of the TNR's board of directors. *See* BNSF Reply at III.D-68 to 69. AEP Texas address that argument *infra* in its discussion of the TNR's insurance.

The STB should reject BNSF's argument that the TNR's board of directors should have seven, rather than five, members. AEP Texas demonstrated in its Opening Evidence that the TNR's board can perform its functions adequately with two inside and three outside directors, particularly since the TNR will not be a publicly-owned or traded company. *See* AEP Texas Op. at III-D-28 to 29. AEP Texas also noted that similar five-person boards for SARRs were recently authorized by the STB in the Eastern rate cases (*Duke/NS* at 74; *Carolina* at 62; *Duke/CSXT* at 59-60). Moreover, in the recent *PSCo/Xcel* proceeding, BNSF itself argued (and the STB accepted) that the SARR's board of directors should have a total of five members. There is no reason why the board of directors for the TNR requires any more directors than BNSF itself advocated in *PSCo/Xcel*. The degree of oversight required by the directors in each case is comparable.

In support of its argument in the instant case that seven directors are needed, BNSF identifies a number of real-world railroads with large boards. *See* BNSF Reply at III.D-65 to 67. Certainly, large railroads with complex traffic bases sometimes have larger boards than the TNR. However, BNSF's own evidence shows that the Kansas City Southern Railway has a board that consists of a total of only five members. *Id.* at III.D-65. BNSF has failed to offer any explanation for its argument that the TNR requires a larger board than KCS, which is a publicly-traded company that operates a considerably more complex railroad than the TNR.

BNSF argues that the board of directors should include the TNR's Vice President of Finance/CFO rather than the Vice President–Transportation. *See* BNSF Reply at III.D-67. Although BNSF provides no explanation for this proposal, AEP Texas accepts BNSF's suggestion with regard to this aspect of the staffing of the TNR's board and notes that there is no associated cost impact. This modification will allow the TNR's Vice President–Transportation to devote additional time to overseeing the operations of the railroad and thus should enhance the efficiency of the TNR.

BNSF also argues that one of the outside directors should serve as a non-executive chairman of the board. *Id.* (“Given the prominence of outside equity capital and the private nature of the firm, Mr. McCarren believes the board should have a non-executive Chairman drawn from the ranks of outside Directors.”) (emphasis added). BNSF does not explain why AEP Texas' proposal that the President serve as the TNR's Chairman would hinder TNR's access to outside equity capital or how BNSF's proposal would improve that access. Accordingly, the STB should accept AEP Texas' proposal to have the TNR's President serve as the Chairman of the Board.⁴²

In a related vein, BNSF argues that at least one of the other outside directors should have sufficient financial expertise to serve as Chairman of the Audit

⁴² BNSF's argument would impact the level of the TNR's expenses only if the STB were to reverse its precedent and find that outside directors should be compensated (and to agree with BNSF that the chairman of the board should receive additional compensation). As AEP Texas explains *infra*, outside directors need not be compensated.

Committee. BNSF offers no explanation of why an Audit Committee is necessary since the audit function is being outsourced, or what impact BNSF's proposed "financial expertise" requirement would have on the G&A costs of retaining such a qualified board member.

* * *

Before proceeding to a discussion of the remaining G&A staff departments, it is worthwhile to address an issue that is common to each of those Departments; namely, the question of appropriate administrative assistant/secretarial staffing. With respect to such staffing, AEP Texas has assigned one administrative assistant to the President of the TNR, and four additional secretaries to a pool within the Law and Administration Department who can perform work on an as-needed basis for all staff departments located at the Alliance corporate headquarters. *See* AEP Texas Op. at III-D-39.

BNSF, on the other hand, assigns one administrative assistant to the President of the TNR, and assigns one secretary to each Vice President. Since BNSF adds an additional Department to the TNR configuration (and thus an additional Vice President), BNSF's allocation of one secretary per Vice President yields a total of five secretaries (in addition to the administrative assistant assigned to the President). Finally, BNSF adds an additional secretary to the Law and Administration Department and an additional secretary to the Transportation Department to "assist the other employees in the department" (*see* BNSF Reply at III.D-98) even though BNSF's version of the

Transportation Department includes only the Vice President–Transportation and the two secretarial positions. This is, without question, an excessive number of secretaries to assign to a single Vice President who has no other direct reports under BNSF’s G&A proposal. (BNSF has reassigned twelve Transportation Department employees from the G&A to the Operating staff).

TABLE III-D-20 Comparison of Secretarial Staffing			
Secretarial Position	AEP Texas Staffing	BNSF Staffing	Difference
President’s Office	1	1	0
Finance and Accounting	0	1	1
Law and Administration/ Pool	4	2	(2)
Marketing Department ^{1/}	0	1	1
Transportation Department	0	2 ^{2/}	2
Engineering and Mechanical	0	1	1
Total	5	8	3
^{1/} AEP Texas does not include a separate Marketing Department in its TNR staffing, but instead includes the Marketing function within the Transportation Department. ^{2/} In light of BNSF’s decision to relocate the vast majority of the TNR’s Transportation Department to Operating employee status, the BNSF’s three-member Transportation Department consists of one Vice President and two secretaries. <i>See</i> BNSF Reply at III.D-62 to 63.			

AEP Texas submits that the use of a pool of four secretaries is likely to be more efficient and effective than BNSF’s proposed staffing in meeting the secretarial

needs of the TNR's four Departments. Operating in such a pool fashion, the various secretaries will be able to respond to variations in individual workload without the efficiency-inhibiting practice of Department labels that BNSF would impose on the TNR.⁴³ In any event, there is no reason why each of the four individual secretaries in the TNR's pool could not be given principal responsibility for one of the four TNR Vice Presidents, thus making this "dispute" between the parties largely an issue of labeling and not one of any genuine substance.

In addition, as AEP Texas explains *infra*, there is no valid reason to separate the marketing function into a separate Department. Consequently, just as there is no need for another Vice President to head this department, there is no need for the additional secretary that BNSF proposes for that Vice President. Nor is there any need to add a second secretary to the Transportation Department. Certainly, in the configuration that BNSF proposes (*i.e.*, a single Vice President plus secretarial support), the Vice President of Transportation does not require the exclusive use of two secretaries. Even in AEP Texas' rebuttal configuration (which includes the Vice President of Transportation, the Director of Customer Service, eight Customer Service Managers, and two Marketing Managers), there is no reason that this Department requires a greater level of secretarial staffing than the other TNR Departments. For example, this ten-member Department (as

⁴³ AEP Texas also notes that fewer secretaries are needed in today's corporate environment of virtually universal use of personal computers with e-mail and word processing capabilities than was the case ten years ago.

staffed by AEP Texas) is far smaller than BNSF's proposed 53-member Finance and Accounting Department, yet BNSF itself assigns only a single secretary to that large Department. *See* BNSF Reply at III.D-61 to 62. The same is true of the Law and Administration Department which has 22 employees.

(b) Finance and Accounting Department

On Opening, AEP Texas provided for a Finance and Accounting Department consisting of 21 employees including a Vice President-Finance and Accounting, who also acts as the TNR's Treasurer and its principal liaison with outside auditors. *See* AEP Texas Op. at III-D-34 to 37. AEP Texas' proposed staffing of the Finance and Accounting Department is identical to the staffing proposed by TMPA in its rate case against BNSF, which involved a SARR system that was very similar to the TNR. *See id.* at III-D-27; *TMPA* at 99. In its decision in the *TMPA* case, the Board accepted TMPA's 21-member Finance and Accounting staff (with the addition of a single administrative assistant) and flatly rejected BNSF's proposal for a 59-member staff. *Id.* at 100 ("While BNSF asserts that TMPA's staffing levels for the GCRR would be inadequate, BNSF's proposal is based on comparisons with its own operations. This is not a meaningful comparison, as the GCRR would be a much different railroad than BNSF.") (emphasis added).

BNSF's proposal for the TNR largely replicates the Finance and Accounting Staff that BNSF proposed in the *TMPA* case. Specifically, BNSF proposes a

staff of 53 persons for this department, including IT specialists. BNSF’s proposal would more than double the size of the Finance and Accounting Department developed by AEP Texas and would itself exceed (by 15 employees) the entire G&A staffing level accepted by the Board in its decision in the *West Texas Utilities* case. *Id.* at 695 (38 G&A personnel are sufficient for a large coal-hauling stand-alone railroad). As the Board held in *TMPA*, this proposal is not “meaningful” because the TNR “would be a much different railroad than BNSF.” *See TMPA* at 100.

The following table presents a summary of the parties’ evidence regarding the staffing of the TNR’s Finance and Accounting Department:

TABLE III-D-21
Comparison of Finance and Accounting Department
Staffing Evidence Submitted by AEP Texas and BNSF

Position	AEP Texas Rebuttal Staffing	BNSF Staffing ^{1/}		Difference
		Narrative	Chart/Costs	
Executive/Treasury Function				
Vice President (& Treasurer)	1	1	1	0
Secretary	0	1	1	1
Assistant Vice President – Treasurer	0	1	1	1
Assistant Treasurer	0	1	1	1
Manager of Administration	1	0	1	(1)
Cash Manager	0	2	2	2
Subtotal	2	6	7	4/5
Controller Function				
Controller	1	1	1	0
Assistant Controller - Revenue	1	0	1	0
Assistant Controller - Disbursements	1	0	1	0
Clerks	2	6	6	4
Revenue Accounting Manager	0	1	1	1
Disbursements Manager	0	1	1	1
Disbursements Clerks	0	2	2	2
Subtotal	5	11	13	6/8

^{1/} BNSF's staffing is set forth in two columns to reflect the inconsistent information that BNSF has presented in its Narrative description of the Finance and Accounting Department and in its Chart (pp. III.D-61 to 62) and its actual cost calculations. These inconsistencies are described in greater detail, *infra*.

Source: AEP Op. at III-D-34 to 37; BNSF Reply at III.D-61 to 63; BNSF Reply at III.D-69 to 89; BNSF Reply electronic workpaper "OPR_EXP.xls," tab "Summary."

TABLE III-D-21 (continued)				
Comparison of Finance and Accounting				
Department Evidence Submitted by AEP Texas and BNSF				
Position	AEP Texas Rebuttal Staffing	BNSF Staffing		Difference
		Narrative	Chart/Costs	
Payroll Function				
Payroll Manager	1	1	1	0
Payroll Coordinator	0	1	1	1
Subtotal	1	2	2	1
Tax Function				
Director of Taxes	1	1	1	0
Financial Reporting Function				
Director – Financial Reporting	0	“Seven” unspecified individuals (see BNSF Reply at III.D- 74)	1	1
Manager – Financial Reporting	1		1	0
Property Accounting Analyst	0		1	1
Sr. Financial Analyst	0		3	3
Manager – Accounting	0		1	1
Subtotal	1	7	7	6
Revenue Analysis/Budgeting Function				
Manager – Revenue Analysis	0	1	1	1
Director - Budgeting and Analysis	1	0	1	(1)/0
Analyst	0	1	1	1
Subtotal	1	2	3	1/2
Equipment Accounting/Misc. Billing				
Manager Car Equipment Accounting	0	1	1	1
Manager Misc. Billing	0	1	1	1
Manager–AAR Billing	1	0	0	(1)
Subtotal	1	2	2	1

TABLE III-D-21 (continued)				
Comparison of Finance and Accounting				
Department Evidence Submitted by AEP Texas and BNSF				
Position	AEP Texas Rebuttal Staffing	BNSF Staffing		Difference
		Narrative	Chart/Costs	
Internal Audit				
Director – Internal Audit	0	1	1	1
Real Estate Function				
Director of Real Estate	0	1	1	1
Manager of Real Estate	0	1	1	1
Subtotal	0	2	2	2
Purchasing Function				
Director of Purchasing	0	1	1	1
Manager of Purchasing	1	2	2	1
Subtotal	1	3	3	2
IT Function				
Assistant Vice President – Information Technology	0	1	1	1
Director - Information Technology	1	1	1	0
IT Specialists	10	10	10	0
Subtotal	11	12	12	1
Finance/Accounting Total	24	49	53	25/29

As the foregoing chart indicates, the most significant overstatements by BNSF relate to the Treasurer function (four or five additional employees, depending on

whether one uses the employee count in BNSF's Narrative or in its chart and cost spreadsheets), the Controller function (six or eight additional employees), and the Financial Reporting function (six additional employees). BNSF's proposed finance/accounting staff is driven by the staffing levels of publicly-held, multiple-commodity Class I and large regional railroads that bill for freight charges on both a trainload and a single-car basis for a large number of customers. Although BNSF acknowledges AEP Texas' proposal to outsource and/or computerize many accounting functions performed in-house by Class I railroads, it nonetheless provides layers and layers of staff (primarily managers) to perform many of the outsourced functions.

Many of the TNR's accounting and finance functions will be handled by computerized packages and programs (including electronic banking) that are now available to the railroad industry, rather than being performed manually by in-house staff employees. These functions and the related programs are described in more detail in AEP Texas' Opening Narrative at III-D-50 to 64 and in the section below on the TNR's IT requirements. The large staff proposed by BNSF is unnecessary, and the staff proposed by AEP Texas in its Opening Evidence (given the many outsourced functions and ample IT systems) is more than adequate to serve the TNR's finance and accounting needs.

BNSF's evidence regarding the staffing of the Finance and Accounting Department is replete with errors and inconsistencies. Consistent with STB precedent, the Board therefore should reject that evidence. *See, e.g., Carolina* at 61 ("[P]ortions of

NS's submission contain inconsistencies, with different staffing levels in its exhibits, workpapers, and narrative.”).

In particular, BNSF's G&A staffing chart and BNSF's cost spreadsheets include several positions as to which BNSF offers no narrative explanation whatsoever. For example, BNSF's Narrative states that BNSF rejects AEP Texas' staffing of the Controller function and that BNSF will replace that staffing with a different configuration. BNSF's chart and its costs, however, include both the “rejected” individuals that had been proposed by AEP Texas (*i.e.*, two Assistant Controllers) and the “replacement” staffing proposed by BNSF. In other instances, BNSF simply includes individuals from the AEP Texas staffing without any acknowledgment of those individuals in its narrative (*i.e.*, the TNR's Manager of Administration and Director of Budgeting and Analysis).

In total, BNSF's Reply Narrative describes forty-nine individuals as constituting the staff of the Finance and Accounting Department, but fifty-three individuals appear in BNSF's G&A staffing chart (and as to which BNSF has included costs for that Department). *Compare* BNSF Reply at III.D-69 to 89 (narrative description) *and* BNSF Reply at III.D-61 to 62 (chart) and Reply electronic workpaper file “OPR_EXP.xls” (costs). A table listing BNSF's various inconsistencies regarding the staffing of the Finance and Accounting Department is included in AEP Texas' Rebuttal

Workpapers Vol. 2, p. 00673. The Board should reject BNSF's evidence in light of these inconsistencies and lack of explanation.

As a preface to its discussion of the TNR's Finance and Accounting Department, BNSF argues that the TNR's annual expenditures on Finance and Accounting functions are too low based upon an evaluation of the amounts spent by Class I railroads in 2001 per 1,000 GTMs. *See* BNSF Reply at III.D-69 to 70. According to BNSF, Class I railroads spent an average of \$0.072 per 1,000 GTMs in 2001 on accounting, auditing, and finance expense, while the TNR will spend only \$0.02 per 1,000 GTMs for the same functions. *Id.* BNSF neglects, however, to address the fact that its own statistics show that CSX spends \$0.22 per 1,000 GTMs on these functions while BNSF spent \$0.05 per 1,000 GTMs and NS spent \$0.03 per 1,000 GTMs for these same functions. *See* BNSF Reply electronic workpaper file "G&A Charts," tab "Finance per GTM."

Completely absent from BNSF's evidence is any explanation as to why NS was able to provide service to its customers while spending less than half of the Class I average on finance-related functions, much less why NS was able to do so while spending only 13.6% of the amount spent by CSX. This tremendous variability amongst real-world Class I railroads raises a significant question with respect to this case. If NS is able to perform its business functions at a cost that is approximately one seventh of the cost incurred by CSX, then a more stream-lined carrier such as TNR, with a more limited

traffic group that moves entirely in repetitive unit-train and trainload service, should be able to improve even further upon NS's progress in providing efficient service.

Following its discussion of the expenditures of real-world Class I railroads, BNSF raises ten areas of criticism regarding the staffing levels that AEP Texas proposed for the Finance and Accounting Department. Each of those criticisms is addressed in turn.

(i) Executive/Treasury Function. In its Opening Evidence, AEP Texas proposed that the Vice President–Finance and Accounting would serve as the TNR's Treasurer (and as its primary liaison with outside Auditors), and that the Vice President would be assisted by a Manager of Administration who manages the company's cash and performs the functions of an assistant Treasurer. *See* AEP Texas Op. at III-D-34 to 35. AEP Texas further explained that there simply is not enough work for a full-time Treasurer on a railroad with a limited number of local customers and a repetitive operation involving a known level of unit-train movements and overheard train movements. *Id.*

In its Reply, however, BNSF adds several individuals to AEP Texas' proposed staffing. Specifically, BNSF staffs the function with a Vice President, an administrative assistant, an Assistant Vice President/Treasurer, an Assistant Treasurer and two Cash Managers for a proposed staffing level of six. *See* BNSF Reply at III.D-72. While not mentioned in BNSF's narrative description of the Finance and Accounting

Department, BNSF's actual costs also include the Manager of Administration that AEP Texas had proposed to assist with the Treasurer function. As such, the difference between the parties' staffing of this function is either four or five individuals.

TABLE III-D-22 Comparison of Executive/Treasury Function Staffing				
Position	AEP Texas Staffing	BNSF Staffing		Difference
		Narrative	Chart/Costs	
Vice President (& Treasurer in the AEP Texas evidence)	1	1	1	0
Secretary	0	1	1	1
Assistant Vice President – Treasurer	0	1	1	1
Assistant Treasurer	0	1	1	1
Manager of Administration	1	0	1	(1)/0
Cash Manager	0	2	2	2
<i>Total</i>	2	6	7	4/5

BNSF's proposed staffing level is excessive, and duplicates functions performed by other members of the TNR Finance and Accounting staff developed by AEP Texas. For example, BNSF's Assistant Vice President–Treasurer will perform the same functions as AEP Texas' proposed Vice President (as assisted by the Manager of Administration), and as indicated *supra*, BNSF fails to offer an explanation as to what other functions the TNR's Vice President–Finance (or the Manager of Administration) would perform.

BNSF's explanation regarding the need for its large Treasury office is as follows:

Based on his experience at WCS and other regional companies, Mr. McCarren provides for an Assistant Vice-President-Treasurer and an Assistant Treasurer and two Cash Managers. This staff is considerably smaller than the seven person Treasury office at WCS; however, it does take into account the fact that TNR is not a public company. Nevertheless, [given its annual revenues], TNR will be required to manage substantial cash flows and balances, and will have significant amounts of debt that need to be serviced.

See BNSF Reply at III.D-72 (emphasis added). As an initial matter, the Treasury staffing that BNSF has proposed is not "considerably smaller" than the seven-person Treasury at the WCS (which BNSF itself acknowledges would be excessive for a non-public company like TNR). On the contrary, under a plausible reading of BNSF's inconsistent evidence, BNSF actually has proposed a seven-person staff for the TNR's Treasury function. See Table III-D-22, *supra*. BNSF's proposed staffing is inconsistent with its own judgment that a TNR Treasury function staffed at the same level as the WCS would be inappropriate.

In addition, with respect to the need to "manage substantial cash flows and balances" and to service "significant amounts of debt," AEP Texas' witnesses Reistrup and Kruzich confirm that modern electronic billing and funds transfer practices will permit the Vice President and the Manager of Administration to adequately manage the TNR's cash flows and debt service. In light of these modern approaches to fulfilling the

Treasury function, BNSF's proposed staffing of the Treasury function is outdated and excessive, and would leave the staff members of such a group largely idle.

(ii) Controller/Disbursement Function. With respect to the Controller function, BNSF states that it is replacing AEP Texas' proposed staffing (one Controller, two Assistant Controllers, and two clerks/analysts) with one Controller, one Revenue Accounting Manager, and six clerks (for a total of eight individuals). See BNSF Reply at III.D-73. As noted *supra*, however, BNSF's actual costs also include the two Assistant Controllers that AEP Texas proposed in its Opening Evidence (for a total of ten individuals).

In addition, BNSF adds a Manager and two clerks for the Disbursements function. BNSF thus includes a total of 11 (or 13) individuals to perform the traditional functions of a Controller's office (*i.e.*, revenue and disbursements). If BNSF's inclusion of costs for the two Assistant Controllers was an oversight, and the two Managers that BNSF has proposed are viewed as substitutes for the two Assistant Controllers, then the only actual difference between the parties is BNSF's inclusion of six additional clerks.⁴⁴ Since BNSF offers no explanation whatsoever as to the need for these six clerks, the Board should exclude them from the TNR staff. See *FMC* at 169 ("[W]e will not accept personnel requirements without some discussion of the duties that the proposed

⁴⁴ AEP Texas has proposed to compensate its two Assistant Controllers at a level that is higher than BNSF has proposed for its two Managers.

employees would be expected to perform.”). Moreover, the proposal for six clerks is inconsistent with BNSF’s statements concerning the WCS clerical staff:

TNR’s lower level of traffic diversity, compared to WCS,’
allows TNR to operate with a much smaller and more
productive staff. . . .

. . . Given the probable reduced level of capital expenditures
for TNR, because the plant and equipment are new, two clerks
likely will be sufficient; however, a Manager will be required.

See BNSF Reply at III.D-73 (emphasis added).

(iii) Payroll Function. On Opening, AEP Texas explained that the Controller’s Office would oversee the outsourced payroll function, assisted by the two Clerk/Analysts described previously. *See* AEP Texas Op. at III-D-36 to 37 and Op. electronic workpaper file “TNR GA Outsourcing.xls.” On Reply, BNSF argues that “even with paycheck preparation itself outsourced, considerable oversight and correction activity will be required.” *See* BNSF Reply at III.D-74. On the basis of this observation, BNSF argues that one Manager and one coordinator will be required to supervise this area properly. *Id.* at III.D-73.

On Rebuttal, AEP Texas accepts BNSF’s argument that certain oversight of this outsourced function by a Payroll Manager will be required, but AEP Texas rejects BNSF’s claim that a Coordinator also will be required. BNSF, in fact, offers no explanation regarding the tasks to be performed by the Coordinator (or any explanation as to how those tasks would be distinguished from those to be performed by the Manager).

There is no reason why a single additional Manager could not adequately oversee this outsourced function. As such, AEP Texas is adding a Payroll Manager to its staffing for the TNR but declining to add the Payroll Coordinator to the staff.

(iv) Financial Reporting Function. In its Opening Evidence, AEP Texas proposed that the TNR would employ a Manager of Financial Reporting. See AEP Texas Op. at III-D-37. Specifically, AEP Texas stated that:

. . . [t]he Manager of Financial Reporting is responsible for overseeing monthly accounting closing of the books, preparation of monthly, quarterly and annual reporting packages for review by the Controller, and maintenance of the company's chart of accounts. One individual is sufficient to perform the TNR's financial and accounting reporting functions, largely because the TNR is not [to] be a publicly-held company and does not need to prepare reports to the SEC or to the equity-investment community.

On Reply, BNSF insists that a total of seven individuals are needed to perform this function. While BNSF's narrative lacks any explanation of the different positions to be held by these individuals (or their various responsibilities), BNSF's G&A Chart and its costs list what appear to be the seven different positions that BNSF contemplates. See BNSF Reply at III.D-61 (lines j, k, l, m, and n). The positions included in BNSF's Chart and its costs include the following:

- Director–Financial Reporting;
- Manager–Financial Reporting;
- Property Accounting Analyst;
- Sr. Financial Analyst (3); and
- Manager–Accounting

Since BNSF has failed to offer any explanation of these different positions that it has developed for the Financial Reporting function, the Board should reject each of them. *See FMC* at 169 (“[W]e will not accept personnel requirements without some discussion of the duties that the proposed employees would be expected to perform.”). For example, BNSF provides no explanation as to why both a Director and a Manager are necessary, no explanation as to why three “Senior Financial Analysts” were selected (as opposed to just “Financial Analysts” or no Financial Analysts at all), or what tasks a separate Manager–Accounting or Property Accounting Analyst would perform.

BNSF’s only explanation for its staffing proposal is that “TNR has virtually the same level of operating expense as WCS, and its overall spending exceeds that of WCS.” *Id.* AEP Texas Witness Reistrup notes, however, that WCS was originally formed in 1987 by acquiring most of the railroad assets of the former Soo Line Railroad (“Soo,” now part of CP Rail), which were spun off during the reorganization of the bankrupt Chicago, Milwaukee, St. Paul and Pacific Railroad.⁴⁵ The Soo assets carried with them a large number of employees and their collective bargaining agreements with the predecessor company. In other words, unlike many regional railroads, WCS did not start from a clean sheet of paper, and its complex history of corporate reorganization,

⁴⁵ *See also The Wisconsin Central Story* set forth in AEP Texas Reb. Workpapers Vol. 2, pp. 00628-633 (“By 1991 the company was flourishing, but still held a significant debt dating back to the original purchase. So in May 1991 WCTC went public, raising \$36.2 million. Another stock offering the following year raised \$48.7 million.”)

union labor agreements and large debt is completely different from that of the newly-formed and constructed, non-unionized TNR. It is therefore inappropriate to use WCS as a benchmark to gauge the TNR's financial reporting workload. In any event, BNSF does not explain that the various positions identified for this function are the same as, or even similar to, the specific staffing at WCS.

(v) Revenue Issues/Trends Analysis. BNSF proposes to add an entirely new sub-group to the TNR Finance and Accounting Department to analyze "revenue issues and trends" and to resolve "substantive disputes that could not be quickly settled by revenue accountants." See BNSF Reply at III.D-74. In particular, BNSF proposes that the TNR add one Manager and one analyst to perform this work. According to BNSF, "in an ideal world, most of this work would not be required, [but] the real world of railroading includes overcharges and undercharges, systems issues, miscoding of bills and a host of problems that need to be resolved." *Id.*

The description provided by BNSF for this function is consistent with the requirements of a carrier that transports large volumes of single-car and mixed-freight traffic, not a carrier like the TNR which has only unit-train and trainload movements. Moreover, to the extent that this type of work conceivably could exist for the TNR, it would be performed by the existing Finance and Accounting staff. In this regard, AEP Texas notes that the Director-Budgeting and Analysis and the Manager of Administration

(both of which BNSF has included in its costs but for which BNSF includes no Narrative explanation) could perform this function.

(vi) Equipment Accounting/Billing. BNSF proposes to add two employees with responsibility for equipment accounting and billing: a Manager of Equipment Accounting and a Manager of Miscellaneous Billing. *See* BNSF Reply at III.D-75. BNSF indicates that the Manager of Equipment Accounting would “manage the car hire payable and receivable issues,” oversee the “outsourced routine transactions,” and “handle any financial transactions regarding foreign locomotives on the TNR or TNR’s locomotives when off-line.” *Id.* The Manager of Miscellaneous Billing would handle “billing of non-freight items such as joint facilities, real estate leases and easements, locomotive and freight car repairs, *etc.*” *Id.*

The TNR, however, is not a party to any real estate leases, acquires a very limited amount of land through easements, and operates only over a single small joint facility (UP’s line between Sterling and Union, CO). *See* AEP Texas Op. electronic workpaper file “TNRR Easements.” The TNR’s Assistant Controller– Disbursements (assisted, as necessary, by the two clerks in the Controller’s Office) will have responsibility for this function.

AEP Texas concurs with BNSF that it would be helpful for an additional individual within the Finance and Accounting Department to have principal responsibility for equipment accounting matters (and the limited joint facility). However, there is

insufficient work of the type that BNSF describes to occupy two additional individuals on a full-time basis. Accordingly, AEP Texas is modifying its Rebuttal staffing to add a single “Manager of AAR Billing” to perform these functions (in conjunction with the Assistant Controller and associated clerks).

(vii) Internal Audit. On Opening, AEP Texas provided for the TNR to outsource its auditing function, and AEP Texas included \$250,000 to cover the cost of annual audits. See AEP Texas Op. electronic workpaper file “TNR GA Outsourcing.xls.” Moreover, AEP Texas indicated that the Vice President–Finance and Accounting would be responsible for interfacing with the TNR’s outside auditors. See AEP Texas Op. at III-D-34. On Reply, BNSF has added a Director of Internal Audit, claiming that “a company of this size should not operate without an internal auditor” and that “[n]o matter how well structured an organization may be at startup, it needs to evolve over time and a good internal auditor helps ensure that this evolution does not compromise the essential system of checks and balances in a large organization.” See BNSF Reply at III.D-76.

BNSF’s explanation smacks of the jargon of productivity engineering and managerial consulting common to large organizations, and has no place in a least-cost, most efficient SARR. It is fundamentally inconsistent with the stand-alone concept to employ a Director (at considerable cost) to do nothing other than to evaluate whether the other executives (and redundant layers of management proposed in BNSF’s evidence) are managing each other properly, particularly insofar as the TNR already is spending

\$250,000 per year to pay an outside firm to undertake auditing responsibility. The Board therefore should reject BNSF's proposal.

(viii) Information Technology. BNSF addresses the IT subdepartment of the TNR primarily in connection with its discussion of the Finance and Accounting Department. AEP Texas addresses IT staffing and outsourcing at pp. III-D-146 to 162, *infra*.

(ix) Purchasing Function. On Opening, AEP Texas staffed the Engineering and Mechanical Department with a Manager of Budgets and Purchasing. *See* AEP Texas Op. at III-D-33. AEP Texas also explained that “[t]he acquisition of materials for locomotive, equipment and program track maintenance is handled by the appropriate contractor, with no need for direct participation by TNR employees.” *Id.*

On Reply, BNSF proposes to add a Director of Purchasing and two Purchasing Managers to the Finance and Accounting Department. *See* BNSF Reply at III.D-79. Notably, however, BNSF does not include the Manager of Budgets and Purchasing that AEP Texas had proposed in its version of the TNR's Engineering and Mechanical Department. *Id.* at III.D-63. Consequently, the dispute between AEP Texas' Opening evidence and BNSF's Reply amounts to the question of whether purchasing can be accomplished by a single Manager or requires a Director and two Managers.

In discussing the purchasing function, BNSF first states that it includes “material handling personnel in the Engineering Department, as proposed by AEP

Texas.” *Id.* It is not clear, however, what proposal BNSF is referencing, and it also is not clear what personnel BNSF has included. BNSF’s Engineering and Mechanical Department includes only a Vice President, an Administrative Assistant, and a clerk. *Id.* In any event, BNSF continues to state that despite this staffing, a “centralized purchasing authority” would be required “for an enterprise of this size.” *Id.* at III.D-79. However, BNSF overlooks the fact that AEP Texas has provided for a Manager of Budgets and Purchasing in the Engineering and Mechanical Department. As such, BNSF overlooks the fact that a “centralized purchasing authority” already exists.

Nevertheless, because of the importance of this function, on Rebuttal, AEP Texas is adding one Manager of Purchasing to the Finance and Accounting Department. This individual will work in conjunction with the Manager of Budgets and Purchasing in the Engineering and Mechanical Department (thus equaling BNSF’s proposed total of two Managers responsible for purchasing). The Board should reject BNSF’s accompanying suggestion, however, that a Director is needed to supervise this function. There is simply no logical reason why a least-cost, optimally efficient SARR would employ a Director to oversee two Managers. In fact, Witness Reistrup observes that in his experience, no supervisory employee should be added to a staff without at least six direct reports. Otherwise, there is insufficient work for the supervisor to supervise and administration becomes an end in itself (which leads to inefficiency). BNSF’s proposed Director thus is unnecessary and unreasonable.

(x) Real Estate. BNSF proposes to add a Real Estate sub-department with two individuals, a Director and a Manager. See BNSF Reply at III.D-79. BNSF argues that this sub-department is necessary because the TNR will face issues related to “crossing, licenses and easements for utility lines, cable TV and the like.” *Id.* Significantly, while BNSF insists that additional employees are needed to interact with entities seeking easements over the TNR’s line, BNSF does not credit the TNR with any revenues associated with such easements. In Mr. Reistrup’s experience, the annual revenue from such easements for a railroad the size of the TNR exceeds the salaries of two individuals. While it may take some time to negotiate agreements regarding such access, BNSF has not explained why two full-time employees (one of whom reports to the other) are required to perform this function. The TNR’s Assistant Controller–Revenue (assisted, as necessary, by the two clerks in the Controller’s office) can easily handle the function.

BNSF’s claim that additional real estate personnel are necessary because the TNR’s operations and facilities will change over time is incorrect. There is no plan to modify the TNR in a manner that would create a need to “acquire new property for new facilities.” See *TMPA* at 101-102 (rejecting BNSF’s argument that real estate staffing was required and noting that “since no new facilities would need to be constructed after the GCRR’s initial construction,” there would be “no need for additional land and no corresponding need for a legal staff to handle real estate matters.”).

Finally, even if there were any other real estate-related issues that actually impacted the TNR, the Law and Administration Department is adequately staffed (and has an adequate outsourcing budget) to handle such matters. Consequently, the Board should reject BNSF's proposal to add redundant staffing for this function.

BNSF also raises a number of issues with respect to the outsourcing of Finance and Accounting-related functions:

First, BNSF argues that the annual audit budget should be increased from \$250,000 to \$275,000, notwithstanding the fact that WCS spent less than that amount on audit fees in 1998, 1999, and 2000. *See* BNSF Reply at III.D-80. In support of its cost increase, BNSF claims that “[g]iven the increased scrutiny of corporate auditing in recent years, auditing fees have increased since 2000.” *Id.* BNSF's argument, however, seeks to attribute events related to publicly-traded companies to the TNR, and BNSF's argument imposes subsequent developments onto costs for the year 2000 (which BNSF then would increase through its cost increase for the subsequent years in which the costs increases supposedly occurred). As such, BNSF's approach reflects a double-count of purported cost changes. The Board should reject BNSF's proposed \$15,000 cost increase for the TNR's annual audit budget.

Second, BNSF states in a single sentence, without any elaboration whatsoever, that “start-up tax consultation would likely total an additional \$15,000.” *See*

BNSF Reply at III.D-80. In the absence of any support for this bald assertion, the Board should reject BNSF's proposed cost increase.

Third, BNSF criticizes AEP Texas' alleged failure to provide for adequate information technology outsourcing. IT issues are discussed at pp. III-D-146 to 162, *infra*.

(c) Law and Administration Department

In its Opening Evidence, AEP Texas proposed a total staffing of 12 individuals in the TNR's Law and Administration Department. This staffing included: the Vice President–Law and Administration, two General Attorneys, a Director of Safety and Claims, two Managers of Safety, a Director of Human Capital, a Manager of Training, and four Secretaries. *See* AEP Texas Op. at III-D-38 to 39.

On Reply, BNSF argues that the Law and Administration Department should include 22 individuals. BNSF's staffing of this department reflects the same bias in favor of over-staffing that is evident with respect to BNSF's treatment of the other departments. *See, e.g., PSCo/Xcel* at 65 (adopting complainant's proposed 14-person staffing for the Law, Administration, Human Resource and IT functions and rejecting BNSF's proposed 30-person staffing for those same functions).⁴⁶ The following table summarizes the parties' evidence regarding Law and Administration Department staffing:

⁴⁶ In the instant case, AEP Texas has proposed a 23-member staff for the same combination of functions and BNSF has proposed a 34-member staff.

TABLE III-D-23
Comparison of Law & Administration Department
Staffing Evidence Submitted by AEP Texas and BNSF

Position	AEP Texas Staffing	BNSF Staffing	Difference
Legal Function			
Vice President/Gen. Counsel	1	1	0
General/Staff Attorneys	2	2	0
<i>Subtotal</i>	3	3	0
Safety/Claims Function			
AVP Safety and Claims	0	1	1
Director of Safety & Claims/Loss Control	1	1	0
Managers of Safety	2	2	0
Claims Manager	0	1	1
<i>Subtotal</i>	3	5	2
Human Resources Function			
AVP – Human Resources	0	1	1
Director of Human Capital	1	0	(1)
Director – Recruitment	0	1	1
Director – Personnel	0	1	1
Director – Compensation/Benefits	0	1	1
Analyst	0	1	1
Human Resources Coordinators	0	4	4
Manager of Training	1	1	0
Asst. Manager of Training	0	2	2
<i>Subtotal</i>	2	12	8
Secretarial Function			
Admin. Assistants/Secretaries	4	2	(2)
Total	12	22	10

Source: AEP Texas Op. at III-D-38 to 39; BNSF Reply at III.D-89 to 97.

The major differences between the parties' treatment of the Law and Administration Department are that BNSF has included unnecessary middle management (*i.e.*, two Assistant Vice Presidents and three new Directors), four new Human Resources Coordinators, and two Assistant Managers of Training. Each of BNSF's specific staffing proposals for this department is discussed below.⁴⁷

(1) Safety and Claims. With respect to the Safety and Claims function, BNSF would replace AEP Texas' proposed three-person staffing (*i.e.*, one Director of Safety and Claims and two Managers of Safety) with a five-person staff including an Assistant Vice President–Safety & Claims, a Director–Safety & Loss Control, and three Managers (including two Safety Managers and a Claims Manager). *See* BNSF Reply at III.D-92 and 62 (at lines 3e, 3f, 3g, and 3l). The net difference between these two proposals consists of the addition of the Assistant Vice President and a third Manager.

In the *FMC* case, UP made a similar effort to enlarge the SARR's claims department. The Board rejected that effort, finding that claims on coal traffic would be infrequent:

UP proposed that 16 employees would be needed to handle damage prevention and claims. FMC argues that a smaller staff could handle such duties because the ORR would not terminate a significant amount of traffic and because claims on coal traffic (a significant portion of the ORR's traffic) would be infrequent. Here, FMC has a point. Because claims

⁴⁷ AEP Texas has previously addressed the subject of the proposed administrative assistants/secretaries for this and other departments.

are generally filed with the terminating carrier and because claims on coal traffic are infrequent, it is reasonable to assume that the ORR could do with a smaller staff than proposed by UP.

See FMC at 166 (emphasis added). On the basis of this finding, the Board removed 14 of UP's proposed 16 claims personnel. *Id.*

Like FMC's stand-alone railroad, the TNR will terminate relatively little of its overall traffic, and the TNR's traffic will be composed almost entirely of coal traffic. Moreover, the TNR will not terminate any of its non-coal traffic. As such, there is no basis for including BNSF's excess Claims staffing in the TNR Law Department. On the contrary, the Director of Safety and Claims and the two Managers of Safety included by AEP Texas are sufficient to oversee the outsourced claims function (for which the TNR will pay \$125,000). *See* AEP Texas Op. at III-D-38 and Op. electronic workpaper file "TNR GA Outsourcing.xls."

(2) Human Resources. On Opening, AEP Texas staffed the TNR's Human Resources function with a Director–Human Capital and a Manager of Training. *See* AEP Texas Op. at III-D-39.⁴⁸ In addition, AEP Texas provided that the TNR would outsource its start-up and training needs. *Id.* As a result, the primary responsibility of the

⁴⁸ In its G&A summary chart on III.D-62, BNSF wrongly indicates that AEP Texas proposed a staffing that would include a Human Resources Coordinator instead of a Director–Human Capital. *See* BNSF Reply at III.D-62 (at lines 3h through 3k).

Human Resources staff is to “preserve the TNR’s ability to engage in ongoing operations.” *Id.*

On Reply, BNSF proposes a number of additions to the TNR’s two-member Human Resources function including: (i) upgrading the Director–Human Capital to an Assistant Vice President; (ii) adding three additional Directors to the Human Resources function (including one for Personnel, one for Recruitment, and one for Compensation and Benefits); (iii) adding four Human Resources Coordinators; (iv) adding an analyst under the Director of Compensation and Benefits; and (v) adding two Assistant Managers of Training to support AEP Texas’ Manager of Training. These five proposed changes would yield a 12-person staffing level for the Human Resources function:

TABLE III-D-24
Comparison of Human Resources
Staffing Proposed by AEP Texas and BNSF

Position	AEP Texas Staffing	BNSF Staffing	Difference
AVP–Human Resources	0	1	1
Director of Human Capital	1	0	(1)
Director–Recruitment	0	1	1
Director–Personnel	0	1	1
Director–Compensation/Benefits	0	1	1
Analyst	0	1	1
Human Resources Coordinators	0	4	4
Manager of Training	1	1	0
Asst. Manager of Training	0	2	2
<i>Total</i>	2	12	8

Source: AEP Texas Op. at III-D-39; BNSF Reply at III.D-93 to 96.

BNSF first suggests that the Director–Human Capital that AEP Texas had proposed should be upgraded to an Assistant Vice President. *See* BNSF Reply at III.D-95. AEP Texas submits that this upgrade is unnecessary, and BNSF offers no justification whatsoever for its proposal. *Id.* (stating only that “Mr. McCarren first revises the department by upgrading the Director–Human Capital to an Assistant Vice President.”). BNSF provided no explanation as to why a least-cost SARR would need to make this change and, therefore, it should be rejected by the Board.

As indicated *supra*, AEP Texas proposed on Opening to employ a Director of Human Capital (in addition to a Manager of Training). In its Reply, after proposing to

upgrade AEP Texas' Director to Assistant Vice President, BNSF proposes to add three new Directors to the Human Capital function; namely, a Director–Compensation and Benefits, a Director–Personnel, and a Director–Recruitment. This staffing is excessive, top-heavy and unreasonable for the TNR.

The WCS, which BNSF cites at length in its Reply, employed a total of only three individuals to staff the Human Resources function in 1996.⁴⁹ At that time, WCS operated a total of over 2,000 route-miles and had over 2,000 employees, which is far more than the total staffing level of the TNR. *See* Wisconsin Central 1996 10-K filed with the Securities and Exchange Commission. The TNR will be equally capable of handling its Human Resources function with two internal employees and outsourcing of the training function.

BNSF also proposes to add four Human Resource Coordinators, but in support thereof, comments only that these coordinators will be responsible for “ongoing recruitment of hourly employees once TNR is up and running.” *See* BNSF Reply at III.D-95. BNSF presents no evidence to support the assertion that AEP Texas' existing staffing/outsourcing is insufficient for this task or that an additional four full-time employees could possibly be needed.⁵⁰

⁴⁹ BNSF's witness McCarren served as the President and CEO of WCS from 1996 through 2001. *See* BNSF Reply at III.D-39.

⁵⁰ While BNSF's Narrative indicates that three or four coordinators would be needed (depending upon which staffing levels the Board approves), BNSF's G&A Chart
(continued...)

BNSF further proposes to add an Analyst position under the Director of Compensation and Benefits. BNSF's sole justification for this proposal consists of the following sentence: "Under BNSF's revision of the TNR's staffing this Director would have an analyst." *See* BNSF Reply at III.D-95. BNSF fails to offer any explanation as to what duties this analyst would perform. Given this lack of evidentiary support, the Board should reject this proposed employee. *See FMC* at 169.

Finally, BNSF proposes to add "two assistant managers, to provide ongoing training activities of TNR employees (as distinguished from start-up training) and to provide for supervision of outside training services." *See* BNSF Reply at III.D-96. BNSF's only support for this addition is the statement that "WCS had seven operating department trainers: one in Engineering, two in Mechanical and four in Transportation." *Id.* Notwithstanding this description of WCS staffing, however, BNSF does not explain why a staffing of three individuals (one Manager of Training and two Assistant Managers of Training) would be required in an environment such as the TNR's in which training will be outsourced.

With respect to the outsourcing budget for the TNR's Law and Administration Department, BNSF contends that the annual outside legal budget (excluding claims administration) should be increased from the \$375,000 figure that AEP

⁵⁰ (...continued)
and its costs both assume the inclusion of four HR coordinators.

Texas had proposed on Opening to \$1,000,000 (with no explanation whatsoever regarding the individual items that this amount will encompass or any basis for selecting this specific figure). *See* BNSF Reply at III.D-96.⁵¹ In its evidence, however, BNSF itself indicates that this figure substantially exceeds the amount spent by WCS spent in 2000 (*i.e.*, \$821,000) and the amount that DM&E/ICE spends in some unspecified time period (*i.e.*, \$900,000) after deducting legal fees associated with major financing transactions. There is no reason to believe that the TNR will require the level of expenditure on legal fees incurred by these railroads. Moreover, BNSF itself admits that “some reduction in legal expense can be expected for the TNR due to its smaller number of employees” *Id.*

⁵¹ AEP Texas’ electronic workpapers set forth the individual breakdown of this outsourcing figure:

Outside Counsel	
- Retainer for Wyoming law firm	\$50,000
- Retainer for Nebraska law firm	\$50,000
- Retainer for South Dakota law firm	\$50,000
- Retainer for Colorado law firm	\$50,000
- Retainer for Oklahoma law firm	\$50,000
- Retainer for Texas law firm	\$50,000
- Retainer for law firm to handle Federal matters ^{2/}	<u>\$75,000</u>
	\$375,000

^{2/} (FRA/Environmental, *etc*; no SEC work and minimal STB work, e.g. no Max. Rate proceedings)

See AEP Texas Op. electronic workpaper file “TNR GA Outsourcing.xls.”

BNSF also increases the TNR’s Law and Administration outsourcing budget by \$100 per hired employee for “testing” costs, commenting that such testing had a generally beneficial impact on hiring at WCS. *See* BNSF Reply at III.D-97. This proposed addition, like many of BNSF’s other proposals, could conceivably be beneficial but is by no means necessary for a least-cost railroad such as TNR. Notably, BNSF itself does not argue that this testing is strictly required, only that it had “greatly improved” the quality of new hires at WCS and reduced the drop-out/failure ratio that WCS experienced. The Board therefore should reject this expense for the TNR.

BNSF adds \$70 per employee annually for safety awards and incentives, commenting that “[m]ost companies in the railroad industry operate such programs” *See* BNSF Reply at III.D-97. By definition, if “most” (rather than “all”) companies operate such programs, then there are real-world railroads that do not incur this cost. The TNR therefore should not be required to bear this cost.

(d) Transportation Department

In its Opening Evidence, AEP Texas proposed a Transportation Department for the TNR that included 15 individuals. Specifically, this Department included: (i) the Vice President – Transportation; (ii) the Director of Operations Control; (iii) the Director of Train and Locomotive Operations; (iv) the Director of Customer Service; (v) eight Customer Service Managers; (vi) two Marketing Managers; and (vii) a Manager of Operating Rules and Safety. *See* AEP Texas Op. at III-D-26.

In its Reply Evidence, BNSF first contends that a number of the employees that AEP Texas has included within the Transportation Department should be classified as Operating employees. As discussed earlier, AEP Texas agrees that, consistent with the *TMPA* decision, three G&A Transportation employees (the Director of Operations Control, Director of Train and Locomotive Operations and Manager of Operating Rules and Safety) should be re-classified as Operating employees. AEP Texas disagrees, however, that the Customer Service personnel should be treated as Operating employees. AEP Texas also disagrees with BNSF's proposal to add a separate, new department to house the Marketing function.

It is inappropriate to re-categorize the TNR's Customer Service function as an Operating function. Customer Service is properly treated as a G&A function because it is not performed by the TNR employees actually engaged in managing and providing transportation service. The function involves interfacing with the origin mine operators and the TNR's customers, and logically should be closely aligned with both the transportation and the marketing functions. A close working relationship between Customer Service and the other Marketing personnel will also facilitate the TNR's maintenance of its customers without extravagant marketing expenditures. The TNR's customer base will be far more appreciative of good service (and an awareness amongst the Marketing personnel of any service-related issues that those customers have faced) than of sales calls, dinners, golf outings, *etc.*, with Marketing personnel.

(e) Marketing Department

AEP Texas Witness Reistrup's design for the TNR's marketing function is to lodge it in the Transportation Department along with the related Customer Service personnel, with two marketing managers who will supervise the marketing contractor as well as interface directly with the TNR's customer. *See* AEP Texas Op. at III-D-44 to 46. BNSF's G&A witness, Reilly McCarren, proposes to separate the TNR's marketing staff (which under BNSF's proposal would not include the nine Customer Service personnel) into a new department, headed by a Vice President and with an Assistant Vice President, six Marketing Managers and a secretary. This proposal reflects the tendencies toward over-departmentalization and excessive layers of management that are characteristic of BNSF's evidence.

In criticizing AEP Texas' marketing plan for the TNR, Mr. McCarren disparages Mr. Reistrup's experience at the Monongahela Railway ("MGA"), where Mr. Reistrup led the marketing effort as an outside contractor and later as President from 1982 to 1992.⁵² Mr. McCarren claims to have direct experience with MGA while a Regional Superintendent at Conrail during part of the same period, and asserts that "the bulk of the coal marketing effort with respect to joint MGA-Conrail traffic was performed by Conrail

⁵² Mr. McCarren failed to mention the fact that Mr. Reistrup also served for seven years as Vice President-Intermodal and later Senior Vice President of Marketing and Sales at the Illinois Central Railroad.

employees.” *See* BNSF Reply at III.D-101 to 102. With all due respect, Mr. McCarren does not know what he is talking about.⁵³

When Mr. Reistrup was a marketing consultant for the MGA it was owned one-third each by Penn Central (later Conrail), Baltimore & Ohio (later CSX) and the Pittsburgh & Lake Erie, and P&LE served as Chairman of the Board. The MGA originated coal traffic which was interlined with all three carriers. During the ten years in which Mr. Reistrup acted as the MGA’s Chief Traffic Officer (this included both the six-year period when he was its marketing consultant and the subsequent four-year period when he served as its President), its coal traffic tripled – largely due to his efforts. Mr. Reistrup helped expand the market for MGA-originated coal to the Midwest and abroad. For example, when Mr. Reistrup started with MGA in 1982 it handled no export coal. When he left the railroad in 1992,⁵⁴ 20 percent of its traffic was export coal. Conrail, in particular, became more and more dependent on the MGA for coal during Mr. Reistrup’s tenure there, as the other Pennsylvania coal mines Conrail served were in a death spiral of declining production and poor coal quality.

⁵³ Mr. Reistrup confesses that he does not recall Mr. McCarren amongst the many Penn Central and Conrail officials that he worked with during his tenure at the B&O and the MGA. Mr. McCarren appears to have fit the mold of a typical Conrail or Pennsylvania Railroad/Penn Central superintendent, who knew virtually nothing about marketing.

⁵⁴ Conrail became sole owner of the MGA after Mr. Reistrup departed.

When Mr. Reistrup took over the MGA's marketing function in 1982, the three carriers that owned it were subsidizing it to the tune of approximately \$8.00 per carload. Six years later, Mr. Reistrup was named President of the MGA, largely as a result of his highly successful marketing efforts, and at the urging of Michael Ward who is now Chairman of CSX. By the time he left the railroad in 1992, the MGA was earning net income of 20 percent after taxes – far better financial results than Conrail (which by then was its sole owner) was achieving. In short, while Conrail marketing personnel certainly assisted Mr. Reistrup with the marketing of joint MGA-Conrail coal traffic, this traffic represented a minority of the MGA's business and the overall results of Mr. Reistrup's marketing efforts speak for themselves.

Mr. McCarren's proposal to create a separate Marketing Department for the TNR and to add both a Vice President and an Assistant Vice-President of Marketing is probably a vestige of the top-heavy management approach he learned while at Conrail. The Assistant Vice President in particular represents yet another needless layer of middle management. The TNR's marketing needs are limited given its stable traffic base which consists primarily of a single commodity, its small number of origins and local destinations, and limited number of customers.⁵⁵ Most of the TNR's marketing needs are

⁵⁵ The TNR has a total of only five local destinations, three of which are power plants operated by operating subsidiaries of Xcel Energy which handles coal procurement and transportation for them. Thus, the TNR effectively has only three local customers.

met by out-sourcing, with ample supervision from the Director of Customer Service and two Marketing Managers who also focus on the TNR's local customers and the origin mines.

Mr. McCarren assigns a total of six Manager-level Marketing employees. Two of them (styled "Manager-Coal Marketing") would handle marketing related to the TNR's coal traffic and two of them (a "Market Manager–Intermodal" and a "Market Manager–Carload") would handle marketing for the TNR's non-coal overhead traffic. Two more individuals would occupy "Manager–Marketing Support" positions. *See* BNSF Reply at III.D-107.

This staffing proposal is nonsensical. There is no reason to assign two individuals to the non-coal function (which accounts for approximately 5% of the TNR's business) when BNSF itself has assigned two individuals to the coal function (which accounts for approximately 95% of the TNR's business). Since the non-coal traffic is entirely overhead traffic, there is no reason why the TNR's marketing structure as proposed by AEP Texas (*i.e.*, two in-house personnel and two FTE equivalent outside contractors) could not handle this minor addition to the bulk of their work.

In seeking to justify the inclusion of two additional Marketing "Support" Managers, BNSF attempts to distort AEP Texas' evidence by claiming that AEP Texas has provided for these individuals in its staffing proposal. *See* BNSF Reply at III.D-107 n.113 ("These two [Marketing Support] managers are the same as those proposed by AEP

Texas in its evidence.”). BNSF’s statement is both wrong and misleading. The two Marketing Managers that AEP Texas proposed will not be relegated merely to a “support” function, and AEP Texas’ evidence does not suggest that they will. On the contrary, these two Managers will perform nearly the identical work as BNSF’s Managers of Marketing. Because such a high percentage of the TNR’s business involves coal traffic, and the remaining traffic consists entirely of overhead traffic which BNSF both originates and terminates, one of the two Market Managers can spend a part of his time on non-coal marketing matters.

BNSF also seeks to justify the addition of Marketing Support personnel by claiming that the TNR’s Marketing staff will not receive support from Customer Service personnel who (under BNSF’s staffing proposal) are treated as Operating personnel. *See* BNSF Reply at III.D-104. This justification is entirely improper because BNSF itself is the party who has argued that the Customer Service personnel and the Marketing staff should be separated. Rather than providing support for BNSF’s claim that Marketing Support personnel must be added to the TNR staff, this argument actually supports AEP Texas’ organizational structure in which the Customer Service and Marketing functions are kept together in the Transportation Department. The importance of the coal service and marketing function is enhanced by making it the responsibility of a single, important Vice President: the Vice President–Transportation.

BNSF also argues that additional Marketing expense will be necessary (both in terms of additional Marketing Managers and increased outsourcing costs) as the TNR's traffic level increases during its 20-year life. *See* BNSF Reply at III.D-108. BNSF's argument is illogical because the TNR will not be adding new customers (particularly utility customers). Rather, its existing customers will be increasing their traffic gradually as demand for electricity grows. With respect to non-coal merchandise traffic, AEP Texas has assumed that this traffic does not grow but rather remains stable during the 20-year DCF period. Since BNSF both originates and terminates this traffic (the TNR participates only as an overhead carrier between Amarillo and Oklaunion), it is logical to assume that BNSF will lead the marketing effort with respect to this traffic.

BNSF also proposes to increase the outsourcing budget for the Marketing function from \$120,000 to \$150,000 per year, based on Mr. McCarren's review of WCS salaries and his "estimate" of what individuals "of this caliber and experience" would cost. *See* AEP Texas Op. electronic workpaper file "TNR GA Outsourcing.xls" and BNSF Reply at III.D-109. In reaching his total, however, Mr. McCarren begins with assumed salary levels for two full-time equivalent individuals, but then includes additives for social security taxes, health benefits, and office, travel, and miscellaneous expenses, which are precisely the types of expenses that outsourcing of the function is intended to avoid. *Id.* As such, BNSF's estimate of outsourcing costs is unreasonable and should be rejected by the Board.

By way of summary, BNSF has proposed a separate Marketing Department with its own Vice President, two coal Market Managers, an additional two non-coal Market Managers (to handle less than 5% of the railroad's business, which is all overhead traffic in any event), and two support Managers who are supposedly needed because BNSF has removed Customer Service support from the Transportation Department. Notwithstanding the additional staffing, BNSF has also proposed to increase the TNR's out-sourced marketing budget. BNSF's proposals are illogical and certainly do not meet the Board's requirement that staffing increases proposed by the defendant on Reply must be shown to be justified and reasonable for a least-cost, most efficient stand-alone railroad.

(f) Engineering and Mechanical Department

Minor differences exist with respect to the TNR's Engineering and Mechanical Department. These include: (i) BNSF's inclusion of an Administrative Assistant which AEP Texas addresses *supra*; (ii) BNSF's exclusion of the Manager of Budgets and Purchasing (which AEP Texas addresses in its discussion of the Purchasing function within the Finance and Accounting Department); (iii) BNSF's unexplained addition of a Clerk to this department; and (iv) BNSF's reclassification of the Director of Mechanical Services as a non-Operating employee and its reclassification of the Manager of Testing/Environmental as an Operating employee.

Although BNSF indicates that both the Director of Mechanical Services and the Manager of Testing/Environmental should be reclassified as Operating employees (*see* BNSF Reply at III.D-63), BNSF appears to have classified the Director of Mechanical Services as a Non-Operating employee. *See* Reply at III.D-34 to 35. In any event, both positions are administrative staff positions and AEP Texas continues to include them in its G&A personnel. Otherwise, the Mechanical side of the Engineering and Mechanical G&A staff, as proposed by BNSF, would consist (in addition to the Vice President—Engineering and Mechanical) entirely of an Administrative Assistant and a Clerk. As proposed by AEP Texas, the Engineering and Mechanical Department includes the Vice President, the Director of Mechanical Services, the Manager of Budgets and Purchasing, the Chief Engineer and his direct reports, and the Manager of Testing/Environmental. The Engineering personnel are discussed in connection with the TNR’s maintenance-of-way staffing in Part III-D-4, *infra*.

ii. Compensation

On Opening, AEP Texas calculated compensation levels for the TNR’s G&A staff based on data contained in BNSF’s Wage Forms A and B with six exceptions. The salaries for the TNR’s President, four Vice Presidents, and Controller were based on salaries, including bonuses, paid for similar executive positions by the Wisconsin Central Railroad in 2000. *See* AEP Texas Op. at III-D-39.

In its Reply evidence, for non-executive level salaries, BNSF relies upon 2000 BNSF Wage Forms A and B average annual salaries de-escalated to second quarter 2000 levels. *See* BNSF Reply at III.D-110. For executive level salaries, BNSF estimates compensation based on a review of executive level compensation at Class I, II, and III railroads. AEP Texas will address each of BNSF's various objections to AEP Texas' proposed compensation for the G&A staff in turn.

(a) Fringe Benefit Ratio

First, BNSF proposes to increase the TNR's fringe benefit ratio of 33.9%. *See* BNSF Reply at III.D-110. Rejecting AEP Texas' date-specific approach to calculating the appropriate fringe benefit ratio for 2Q00, BNSF instead uses a three-year average of 43.2%. This figure is excessive and improper for the TNR. As an initial matter, BNSF's three-year average was composed of data for a varying group of railroads. A careful review of the data selected by BNSF to compute its average indicates that, although significantly lower fringe benefit levels were paid by some of the large carriers during each of the three years selected by BNSF for its analysis, BNSF elected to utilize much higher fringe benefit ratios. Also, in certain instances, BNSF varied – on a year-to-year basis – the group upon which its average was based.

BNSF's fringe-benefit comparisons for other carriers are summarized in the following table:

TABLE III-D-25 BNSF's Calculation of Fringe Benefits			
Year 2000	G&A		
	Fringe Benefits	Salaries & Wages	%
BNSF	70,960	194,100	36.6%
UP	75,572	329,712	22.9%
CSX	62,442	114,634	54.5%
NS	94,028	71,821	130.9%
KCS	4,376	11,367	38.5%
Soo	5,710	13,442	42.5%
IC	10,983	21,541	51.0%
GTW	2,226	4,098	54.3%
Year 2001	G&A		
	Fringe Benefits	Salaries & Wages	%
BNSF	105,008	201,717	52.1%
UP	89,121	226,956	39.3%
CSX	73,720	116,726	63.2%
NS	25,020	17,900	139.8%
KCS	2,431	12,079	20.1%
Soo	5,237	11,734	44.6%
CN/IC	4,387	20,002	21.9%
CN/GTW	1,468	3,266	44.9%
Year 2002	G&A		
	Fringe Benefits	Salaries & Wages	%
BNSF	91,774	218,985	41.9%
UP	102,332	269,604	38.0%
CSX	98,771	116,001	85.1%
NS	6,267	15,733	39.8%
KCS	7,241	13,623	53.2%
Soo	5,666	12,027	47.1%
CN/GTW	14,299	(27,339)	-52.3%
Average	G&A		
RRs with < \$1B Freight Expense - 2000			46.6%
RRs with < \$1B Freight Expense - 2001			32.9%
RRs with < \$1B Freight Expense - 2002			50.1%
RRs with < \$1B Freight Expense - 2000 - 2002			43.2%
Note: Shaded Areas include the figures actually used by BNSF.			
Source: BNSF Reply electronic workpaper file "Fringe Benefits.xls" (citing Schedule 410, 2000 - 2002 R-1s).			

BNSF's own workpaper reveals that the "least cost" fringe benefit ratio (amongst the carriers that BNSF previously utilized in its evidence as part of the appropriate "peer" group) was lower than the 33.9% fringe benefit ratio submitted on Opening by AEP Texas: 22.9% for 2000 (UP); 20.1% for 2001 (KCS); and 38.0% for 2002 (UP). The three-year average of these ratios is 27.0%.

Moreover, BNSF fails to point out that three of the four carriers it includes in its calculation are wholly-owned subsidiaries of much larger carrier whose revenues exceed the \$1.0 billion threshold set by BNSF. These carriers are Soo (owned by CP) and IC and GTW (both owned by CN). This leaves only the KCS as a carrier with revenues truly below \$1.0 billion. KCS's G&A fringe benefit ratios for the three years selected by BNSF range from 20.1 to 53.2 percent with an average of 37.3 percent for the period.

In light of the irregularities in BNSF's analysis of supposedly representative fringe benefit ratios, AEP Texas continues to use the 33.9 percent fringe benefit ratio that it calculated from AAR data in its Opening evidence.

**(b) Compensation for Outside Members
of the Board of Directors**

On Opening, AEP Texas indicated that outside directors would only be compensated for their travel expenses. *See* AEP Texas Op. at III-D-29. On Reply, BNSF argues that the outside members of the board should be compensated at a rate of \$70,000 per year (including travel and expenses) for the Chairman and \$40,000 per year (including travel and expenses) for the other four outside members. BNSF's own

statistics regarding the compensation of Board members for real-world railroads, however, demonstrate the unreasonableness of this proposal. *See* BNSF Reply at III.D-65 to 67 (reflecting considerably lower compensation levels for a number of real-world railroads, with no indication that any of the directors for these railroads were representatives of the customer or financial communities).

Moreover, Board precedent supports the use of uncompensated outside directors for SARR Boards. *See PSCo/Xcel* at 70-71. AEP Texas therefore declines to accept BNSF's claim that the TNR's outside directors must be compensated.

(c) TNR President's Compensation

In its Opening evidence, AEP Texas based the TNR President's compensation on the 2000 salary of the WCS President, who then was Reilly McCarren. *See* AEP Texas Op. at III-D-40 and BNSF Reply at III.D-115. Mr. McCarren, now BNSF's G&A witness in this proceeding, states that the \$358,590 2000 salary, including bonus, that AEP Texas included in its Opening Evidence, inappropriately benchmarks his compensation because AEP Texas did not include the cost of his stock options in 2000.⁵⁶ It is interesting that Mr. McCarren would disagree with AEP Texas in not recognizing this as an expense, since WCS, at the time, did not recognize it as an expense to its investors. *See* AEP Texas Rebuttal Workpapers Vol. 2, pp. 00635-651. WCS also did

⁵⁶ BNSF's Reply evidence indicates that there is a disparity between AEP Texas and BNSF regarding this \$358,590 figure (*see* BNSF Reply at III.D-116 and 118), but that disparity arises as a result of indexing.

not include stock options in its calculation of net income in its 2000 10-K, but per GAAP standards, disclosed its granting of stock options in a footnote instead. *Id.* Further, other companies such as Genesee & Wyoming, Kansas City Southern, and RailAmerica have not expensed stock options over the last several years.

In any event, BNSF instead bases the TNR President's compensation roughly on that of KCS's CEO in 2001 of \$540,000. *See* BNSF Reply at III.D-115 to 117. To arrive at this figure, BNSF compares the TNR to real-world railroads and concludes that IC, KCS and Soo had revenues "closest to – but lower than" the TNR and therefore would be good proxies. *Id.* at III.D-116. BNSF considers KCS to be a good benchmark because the KCS CEO had the lowest compensation in 2001 of the these three carriers.

BNSF does not explain, however, why a least-cost, most efficient carrier would pay its President more than that of WCS; nor does BNSF provide any reasonable rationale as to why KCS's compensation level would be more appropriate. In fact, KCS is particularly unsuitable as a benchmark because KCS operates over twice as many route miles as the TNR and – if KCS's investments in the Tex Mex Railway and the Mexican carrier, TFM, are considered – KCS has investments in approximately 6,000 North American route miles (as well as an investment in the Panama Canal Railway Company). For this reason, KCS is a far larger, far more complex organization than the TNR. AEP

Texas therefore continues to use the \$358,590 President's salary, indexed to 2Q00, in its Rebuttal evidence.

(d) TNR Vice President Compensation

Next, BNSF improperly increases Vice President salaries from \$223,217 to \$250,000 or \$300,000, depending on the particular Department involved. *See* BNSF Reply at III.D-117. BNSF's approach to Vice President compensation is plainly inconsistent with BNSF's approach to the President's compensation, and reflects an evident desire to "cherry-pick" executive salaries to inflate G&A expenses. Specifically, after claiming that KCS is the most comparable railroad to the TNR and that its CEO's salary is a good proxy for the TNR's CEO salary, BNSF declines to use KCS's Vice President salary as a proxy for the TNR Vice President salary. Rather, BNSF assembles another menu of potential benchmarks, and then arbitrarily selects \$300,000 for Executive Vice Presidents, and \$250,000 for the Vice Presidents of smaller departments. Because BNSF's approach is irrational and inconsistent, the Board should reject BNSF's evidence.

Interestingly, if KCS's salaries had been used, the average Vice President compensation would have been only \$221,253 according to data in BNSF's evidence. *See* BNSF Reply at III.D-113. BNSF provides no valid reason why the \$300,000 and \$250,000 figures are more accurate representations of the TNR Vice Presidents' compensation than the amounts AEP Texas used. AEP Texas' figure of \$223,217 is

based upon actual compensation at the Wisconsin Central in 2000 and is the best evidence of record.

It also should be noted that AEP Texas' proposed number of TNR employees at the Vice President level for the TNR is, if anything, conservative. Of the railroads for which BNSF provided data, the great majority (including some Class I carriers) have four Vice Presidents. Carriers such as the Genesee & Wyoming, the Providence and Worcester, and WCNA (WCS's parent), however, only have three Vice Presidents for their North American rail operations. BNSF, on the other hand, proposes five vice presidents for the TNR and then adds an additional four assistant vice presidents. Under BNSF's proposal, this least-cost, most efficient carrier would have eleven employees (*i.e.*, the TNR's President, Vice Presidents, Assistant Vice Presidents, and Controller) earning more than \$200,000. BNSF's overly-generous executive compensation levels should be rejected.

**(e) TNR Compensation Issues
for Other G&A Employees**

BNSF increases a number of other G&A salaries but does not explain the differences between the increased salaries that it proposed and the salaries proposed by AEP Texas. As stated previously, on Opening, AEP Texas developed non-executive G&A salaries based on BNSF's 2000 Wage Forms A and B together with the Uniform System of Accounts ("USOA") classification of employees. BNSF apparently used this same methodology. The differences in the parties' salaries are based on one of two

reasons. First, as discussed with regard to salaries for Operating personnel, on Opening, AEP Texas indexed annual 2000 wages to the 2Q00 wage and price levels using the relationship between the AAR second quarter wage index to the AAR Western Region annual wage rates index. In contrast, BNSF indexed 2000 wage rates based on the relationship between the AAR second quarter wage index and the average of the wage index of each of the four quarters of 2000. In *PSCo/Xcel*, the Board rejected the approach used by AEP Texas in Opening in favor of BNSF's approach. See *PSCo/Xcel* at 71. On Rebuttal, AEP Texas has used the approach accepted in *PSCo/Xcel*.

The second difference between the parties with respect to non-executive G&A salaries relates to the assignment of USOA classification codes to individual G&A positions. The different assignments relate to three categories of employees: (i) secretaries and administrative assistants; (ii) the Manager of Financial Reporting; and (iii) the Marketing Managers. On Rebuttal, AEP Texas agrees that BNSF's assignment for the Manager of Financial Reporting and the Marketing Managers is preferable and accepts BNSF's designation of these codes. For the Secretary/Administrative Assistant assignment, however, AEP Texas disagrees with BNSF's assignment of code 214 for this position and instead uses USOA code 212 which applies to clerical staff assistants and lead clerks. On Rebuttal, AEP Texas continues to assign USOA code 212 for these positions.

iii. **Materials, Supplies & Equipment**

On Opening, AEP Texas addressed the cost of general and administrative personnel materials, supplies and equipment (*see* AEP Texas Op. at III-D-42 to 43) and included \$151,627 in annual expenses. *See* AEP Texas Op. electronic workpaper file “TNR_OP_EXP.xls.” This amount included separate expenses for the following items: automobiles; office furniture and equipment; utilities; office supplies; corporate computer systems; miscellaneous costs; and annual training expenses. *Id.*

On Reply, BNSF states that, in general, it accepts AEP Texas’ unit costs for materials, supplies, and equipment, but BNSF applies them to the number of G&A personnel calculated by its witness McCarren. *See* BNSF Reply at III.D-120. BNSF also states that where it has “identified specific requirements for the TNR that were not included by AEP Texas, they have been added.” *Id.* However, BNSF’s Narrative never specifies what items have been changed or added or its reasons for the changes or additions.

A review of BNSF’s workpapers reveals that BNSF made several changes to the unit costs that AEP Texas specified on Opening for G&A materials and supplies. First, as with the Operating personnel Materials and Supplies expense, BNSF has proposed a unit price of \$1,169 for desks and chairs. This effectively would require the TNR to finance two sets of desks and chairs for each set it uses, in that BNSF proposes to finance and charge to the base year both the desks the TNR acquires at the beginning of

the 20-year DCF period and those it buys in year five. This is clearly improper and AEP Texas continues to use an annual price of \$435 for desks and chairs which is more than adequate. This purchase price is applied to the G&A personnel positions relied on by AEP Texas in Rebuttal.

Second, AEP Texas supplied its G&A staff with a pool of four-wheel-drive Ford Explorers based on the new purchase price in 2000 of \$25,720. In Reply, BNSF also uses Ford Explorers, with a purchase price of \$28,811. BNSF, however, provides no workpapers supporting its purchase price other than a reference to the “Edmunds.com” website. BNSF does not even specify what year or model Ford Explorer it relies on and therefore, the purchase price it used cannot be verified.

Third, BNSF errs in the calculation of the cost of G&A automobiles in that it assumes a negative salvage value in its cash flow calculations rather than a positive value, thus incorrectly assuming that salvage value is a cash outflow.

On Rebuttal, AEP Texas continues to rely on its year 2000 purchase price of \$25,720 for its Ford Explorers, as the purchase price used by BNSF is unsupported by any workpaper. AEP Texas, however, does change the interest rate used to amortize the cost of automobiles to the Board’s cost of capital for the railroad industry in order to comply with the Board's decision in *PSCo/Xcel*.

The most significant change made by BNSF on Reply, however, consists of its inclusion of \$250,000 for miscellaneous purchased services including “purchased

services and other (sic).” *See* BNSF Reply at III.D-120. BNSF adds that these funds will “pay for miscellaneous costs such as janitorial service contracts, landscaping, catering, and other miscellaneous unplanned operating costs.” *Id.* at III.D-120 to 121. The TNR, however, has no need for the extensive services that BNSF contemplates. For example, the TNR will not engage the services of landscapers and/or catering firms, and certainly cannot be expected to pay \$250,000 per year for janitorial services. Finally, while it is possible that the TNR would incur unforeseen/unplanned costs, BNSF has not provided any rationale for the budget it proposes.

iv. Other G&A Expense

(a) Travel

On Opening, AEP Texas set a travel budget at \$8,000 per employee for certain of the TNR’s 56 G&A employees and for the three outside members of board of directors. *See* AEP Texas Op. at III-D-49.⁵⁷ In total, this amounted to an annual travel budget of \$296,000 (*i.e.*, 37 individuals x \$8,000.00 per individual). *See* AEP Texas Op. electronic workpaper file “TNR_OP_EXP.xls.” AEP Texas’ Opening Narrative, however, incorrectly stated that travel expenses had been included only for each G&A employee at the “Director level or higher” (*id.*), which would have amounted to only 18

⁵⁷ AEP Texas based this estimate on an annual survey of corporate travel managers performed by Runzheimer International, which estimates the annual cost of corporate travel for corporate employees that travel for business. *See* AEP Texas Op. Workpapers Vol. 18, p. 09072.

of the TNR's G&A employees (plus the three outside directors). In fact, AEP Texas included travel costs for all of the TNR's G&A employees except for the following 22 individuals: (i) ten IT Specialists; (ii) five Administrative Assistants; (iii) three Clerk/Analysts; (iv) the Manager of Administration; (v) the Manager of Financial Reporting; and (vi) two Managers of Safety. *See* AEP Texas Rebuttal electronic workpaper file "TNR_OP_EXP_Rebut.xls." AEP Texas submits that it was proper to exclude any travel budget for these individuals since they would not be expected to engage in any travel even at a real-world railroad, much less at a least-cost, most efficient railroad like the TNR.

On Reply, BNSF suggests that the TNR would incur travel expense of 5% of each salary for each of its G&A personnel except that it would incur travel expense at the rate of 15% of the salary for each of its Marketing personnel. *See* BNSF Reply at III.D-108. In total, BNSF submitted an annual travel budget of \$573,958. *See* BNSF Reply electronic workpaper file "OPR_EXP.xls," tab "Summary." There is thus a \$277,958 difference between the parties' Opening and Reply estimates of the annual travel budget for the TNR's G&A employees (part of the difference is due to BNSF's excessive staffing for a separate Marketing Department).

BNSF's travel budget is unreasonable and should be rejected by the Board. BNSF's principal error with respect to travel is that BNSF includes \$155,703 for the annual travel costs supposedly associated with clerical and other non-traveling positions.

In the order set forth in BNSF's electronic workpaper, these positions and individual travel budget amounts include: Administrative Assistant (\$3,461), Secretary (\$3,461), two Cash Managers (a total of \$7,151), Manager–Financial Reporting (\$3,776), Property Accounting Analyst (\$3,225), three Senior Financial Analysts (a total of \$9,674), Manager Accounting (\$3,776), six Revenue Accounting Clerks (a total of \$19,347), Manager Accounts Payable (\$3,776), Manager Payroll (\$3,776), Manager Revenue Analysis (\$3,776), Revenue Analyst (\$3,225), Manager Car Equipment Accounting (\$3,776), two Disbursement Clerks (a total of \$6,449), Payroll Coordinator (\$3,225), Manager Miscellaneous Billing (\$3,776), Manager of Administration (\$3,776), ten IT Specialists (a total of \$32,246), Secretary/Paralegal (\$3,225), Analyst (\$3,225), Claims Manager (\$2,043), Secretary (\$10,384), Administrative Assistant (\$3,461), Secretary (\$6,128), Administrative Assistant (\$3,461), and Clerk (\$2,104). *See* BNSF Reply electronic workpaper file “OPR_EXP.xls,” tab “Summary.” This item alone accounts for 56% of the total \$277,958 travel budget dispute between the parties.

A significant additional portion of the difference between the parties relates to BNSF's inclusion of an inordinately large number of employees in the TNR's various G&A departments. BNSF includes travel expenses for its excessive middle management, its excessive number of support positions, *etc.* Likewise, BNSF's salary-based estimates of travel expense are inflated because of BNSF's excessive salary assumptions.

BNSF's estimate also is improper to the extent that BNSF relies without any empirical support upon its assumption that 5% or 15% travel budget levels will be necessary for TNR executives. At the upper end of the TNR salary structure, BNSF's unsupported 5% assumption generates travel expenses that vastly exceed reasonable levels for a least-cost, most efficient SARR. For example, BNSF assumes that the TNR's Vice President—Engineering and Mechanical would incur \$14,893 in annual travel expenses, and that its Controller would incur \$12,411 in travel expenses. More significant, however, is BNSF's application of the higher 15% travel budget estimate to the following ten positions that it has proposed for the TNR: (i) the Vice President—Marketing (\$44,680); (ii) two Secretaries (a total of \$16,512); (iii) the AVP Coal Marketing (\$33,192); (iv) two Managers of Coal Marketing (a total of \$23,545); and (v) four Market Manager—Other (a total of \$47,090). This travel budget for the Marketing function alone amounts to \$165,019. *See* BNSF Reply electronic workpaper file “OPR_EXP.xls,” tab “Summary.” Such a travel budget is extraordinarily high and is unreasonable for a carrier that outsources its Marketing function and directly serves only five destinations.

Notably, with respect to the middle management positions, the travel budget proposed by AEP Texas actually exceeds the 5% figure relied upon by BNSF for a number of the TNR's G&A employees, including the Director of Corporate Relations, the Director of Customer Service, the eight Customer Service Managers, the Director of

Mechanical Services, the Manager of Testing and Environmental, the Manager of Budgets and Purchasing, the Director of Taxes, the two Assistant Controllers, the Director of Budgeting and Analysis, the Director of Information Technology, the two General Attorneys, the Director of Safety and Claims, the Director of Human Resources, and the Manager of Training.

For all of the foregoing reasons, the Board should accept AEP Texas' travel cost estimates. These estimates are based upon data from an independent source, and they actually exceed the estimates supplied by BNSF for most of the TNR's G&A positions (as properly staffed by AEP Texas).

(b) Start-Up and Training

(i) Start-up

On Opening, AEP Texas assumed that the TNR's employees will be recruited through a combination of methods. *See* AEP Texas Op. at III-D-46 to 50. Specifically, AEP Texas assumed 60 percent of employees will be hired through word-of-mouth, 15 percent will be hired through advertising, 10 percent will be hired through use of executive search firms and the balance will be hired through unspecified "other" means. *Id.* BNSF disagrees with this approach and assumes that all hourly and first level supervisory employees will be hired through advertising and that all employees above the first level of supervisory personnel will be hired through a recruitment firm at a cost of 25 percent of the employee's first year salary. *See* BNSF Reply at III.D-125.

BNSF argues that AEP Texas' approach may be adequate for an established firm but that a start-up company in a tight labor market would not be able to hire a sufficient staff using this approach.⁵⁸ In support of this argument, BNSF cites recent articles and speeches that address UP's current difficulties with hiring train crews. BNSF, however, ignores the fact that the TNR commences its operations in early 2000, at which time there was a surplus of experienced train crew personnel and BNSF was actually laying off T&E employees. *See* AEP Texas Rebuttal Workpapers Vol. 2, pp. 00617-623. BNSF's assumption of a tight labor market is also inconsistent with SAC principles which assume unlimited availability of resources for a SARR.

BNSF states that in Mr. McCarren's experience an executive search firm would be used to hire only the President and 50 percent of the Vice Presidents and Assistant Vice President positions. *See* BNSF Reply at III.D-124. Contrary to the experience of Mr. McCarren cited by BNSF, however, BNSF has elected to hire *all* personnel above the first level of supervisory positions through the use of an executive search firm. Disavowing Mr. McCarren's "experience," BNSF hires 112 TNR employees using an executive search firm, rather than the seven employees that would be hired if

⁵⁸ On the basis of this supposedly tight employee market, the fact that the TNR is a start-up firm, and Mr. McCarren's experience that an executive search firm is used to hire top executives, BNSF proposes to hire all hourly and first level supervisory personnel through use of advertising at a cost of \$1,310 per employee. This amount includes expenses for the placement of advertisements as well as TNR management time related to interviews, placing ads and travel expenses for the new employees. *See* BNSF Reply electronic workpaper file "TNR Training and Recruitment BNSF.xls."

only the President and 50 percent of the Vice Presidents and Assistant Vice Presidents are hired via an executive search firm. In doing so, BNSF arbitrarily increases the amount that the TNR pays to an executive search firm from \$490,069 to \$2.8 million.

The notion that the TNR would utilize a recruitment firm to hire all management staff is not only unsupported by BNSF, but also far-fetched. BNSF basically assumes that the TNR management will have no contacts within the industry by which to network potential hires and will not even try to find candidates through its own advertising. It also assumes that the TNR would select the most expensive recruiting option and follow worst practices in human resources rather than best practices. For example, a recent joint poll by HRnext and BLR.com indicates that 55 percent of human resources managers cited “word of mouth/networking” as the best way to recruit qualified applicants. According to HRnext president, John Brady:

Good HR departments use a variety of approaches. But it’s easy to see why hiring managers prefer this one (word of mouth/networking). When push comes to shove, and they need to fill a position in a hurry, they’ll go with somebody they already know or whose credentials have been vouchsafed by someone else they know and trust. Given the current economy, the cost of using other options may be another factor in leaning so heavily on networking. Talk is, after all, pretty cheap.

See AEP Texas Reb. Workpapers Vol. 2, p. 00669. AEP Texas’ method of following a typical recruiting approach that is more reliant on networking and not exclusively

dependent on an executive search firm is far more consistent with SAC principles, as well as with good Human Resource practices, than BNSF's approach.

In contrast to BNSF, AEP Texas based its TNR recruiting methods on the manner in which employees are hired in the real world. As explained in its Opening evidence, AEP Texas estimated recruiting costs based upon a survey by the employment services company, Drake Beam Morin (DBM), of individuals who recently found jobs: 60 percent of respondents said that they landed a job through networking, 10 percent through a search firm/agency, 15 percent through some type of company advertisement, and 15 percent through another means. *See* AEP Texas Op. Workpapers Vol. 18, pp. 09118-9121. BNSF's proposed recruitment costs should be rejected because they are unfounded and in conflict with the testimony of BNSF's own witness.

On Rebuttal, AEP Texas accepts BNSF's hiring of hourly and first level supervisory personnel through the use of advertising at a cost of \$1,247 per employee.⁵⁹ However, AEP Texas continues to assume that the employees above the first level of supervisory personnel are hired through a combination of word-of-mouth, advertising and an executive search firm. This approach is consistent with Mr. McCarren's recommendation that only seven of the TNR's senior executives would need to be hired through an executive search firm.

⁵⁹ The difference between the \$1,247 used here and BNSF's \$1,310 is related to the difference in the fringe benefit ratios associated with the salaries of the managers and directors who are involved with hiring.

Finally, AEP Texas sees no reason why the TNR would have to pay 25 percent of salary for a recruitment firm when a firm called RailPros that specializes in placing managerial and professional candidates with positions in the railroad industry charges only 10 percent of the first year salary. *See* AEP Texas Op. Workpapers Vol. 18, pp. 09125-9131.

(ii) Training

AEP Texas and BNSF have numerous differences in the amounts included for initial training expense. These differences are principally related to the number of weeks that individual employees are trained and the amount they are paid during training.

As an initial matter, AEP Texas and BNSF agree that not all employees will have railroad experience and must be trained accordingly. On Opening, AEP Texas included \$6.4 million for initial training compared with BNSF's initial training expense of \$22.6 million. The differences in AEP Texas' and BNSF's training expenses are addressed below by experience level and craft.

Inexperienced Trainees Seeking to Become Conductors. For inexperienced trainees seeking to become conductors, AEP Texas based its training cost on that available from AMDG, a firm used by CSX and other Class I carriers as a resource for new conductors. As shown in AEP Texas' Opening workpapers Vol. 18, pp. 09084-9102, the AMDG novice student pays for his or her own tuition and room and board until graduation from the program. At that time, the trainee can expect to be hired by a Class I

carrier and be paid an entry level salary while he or she completes on-the-job (“OJT”) training. Consistent with this documentation, AEP Texas assumed that a novice conductor would complete the AMDG course, pay for his or her own tuition, room and board and would not receive any compensation while earning his or her AMDG credentials. Subsequent to the AMDG classroom training, AEP Texas assumed that the novice conductor would be paid \$670 per week, as per the amount AMDG reports that CSX pays its novice conductors during their 13.5 weeks of OJT training.

In contrast, BNSF indicates that it requires new conductors to take an additional three weeks of classroom training regardless of their credentials and 12 weeks of OJT training. In addition, BNSF pays for tuition and travel expense during the entire 15 weeks of training and at 80 percent of the salary BNSF ascribes to those T&E crew members that work between 255 and 284 shifts per year.

The TNR is a least-cost, most-efficient carrier, and AEP Texas has demonstrated that other Class I carriers pay far less to novice conductors than the amount proposed by BNSF. Further, it is unreasonable to assume that a novice conductor would be paid 80 percent of the amount that BNSF claims is paid to only its highest paid T&E employees. Instead, AEP Texas’ assumption of paying a novice employee a novice wage during training is reasonable. In Rebuttal, AEP Texas continues to rely on its Opening evidence regarding novice conductor trainees.

Experienced Conductors Hired as Conductors. On Opening, AEP Texas relied on a six day classroom program for experienced conductors being hired as conductors offered by Keeping Track, a company that re-certifies experienced conductors and engineers. In addition, AEP Texas provided for two weeks of OJT training for experienced conductors. AEP Texas also paid the conductors 80 percent of their salaries, plus fringe benefits during training.

In contrast, BNSF rejected Keeping Track's re-certification and provided for three weeks of classroom training at the AMDG classroom cost per week and nine weeks of OJT training. BNSF also pays experienced conductors 80 percent of their salaries plus fringes. (As discussed *infra*, AEP Texas and BNSF disagree on the amount of wages to be paid to conductors and engineers and on the amount of the fringe benefit ratio. In the calculation of wages paid during training, both parties use 80 percent of their respective wage rates plus the fringe benefit additive.)

On Rebuttal, AEP Texas accepts BNSF's proposed three weeks of classroom training and nine weeks of OJT training for experienced conductors and continues to pay them based on 80 percent of the AEP Texas wage and fringe rates.

Experienced Conductors Seeking to Become Engineers. On Opening, AEP Texas assumed three weeks of classroom training and five weeks of OJT training for conductors becoming engineers. AEP Texas included costs based on the AMDG fees for the classroom tuition and 80 percent of its wage and fringe rates. BNSF, on the other

hand, assumes five weeks of classroom training and 15 weeks of OJT training for conductors becoming engineers, based on BNSF's statements regarding its own practices.

In 1989, the Federal Railroad Administration ("FRA") proposed rules for the amount of training required for locomotive engineers. These rules, published in the Federal Register on December 11, 1989, require "individuals seeking to become unlimited train service operators," *i.e.*, locomotive engineers, to receive 198 hours of classroom training and 480 hours of OJT training. *See* 54 Fed. Reg. 50,890.⁶⁰ Assuming a 40 hour week, these requirements translate to five weeks of classroom training and 12 weeks of OJT training, which is three weeks less OJT training than BNSF provides. On Rebuttal, AEP Texas accepts BNSF's Reply regarding five weeks of classroom training (because it is consistent with the FRA standard) but AEP Texas declines to accept BNSF's proposed OJT training. This OJT level is unreasonable to the extent that it exceeds the FRA standard. AEP Texas thus modifies its OJT training only to the level of the FRA standard (*i.e.*, 12 weeks of OJT training).

Recertification for Experienced Engineers. On Opening, AEP Texas relied upon Keeping Tracks' re-certification program for experienced engineers. This amounts to an 11-day classroom program and two weeks of OJT training. In contrast, BNSF assumed five weeks of classroom training and 12 weeks of OJT training, which is consistent with the FRA rules, discussed above. On Rebuttal, in order to remove a

⁶⁰ *See* AEP Texas Reb. Workpapers Vol. 2, pp. 00664-668.

difference between the parties, AEP Texas accepts BNSF's Reply evidence requiring five weeks of classroom training and twelve weeks of OJT training for experienced engineers.

Drop-Out Rates. BNSF's Reply also indicates that in Mr. McCarren's experience, 20 percent of trainee conductors and 10 percent of conductors training to become engineers drop out before matriculating. *See* BNSF Reply Narrative at III.D-126. Based on this statement, BNSF increases the costs of training inexperienced conductors and conductors training to become engineers by 20 percent and 10 percent, respectively. BNSF did not indicate what its own experience is with drop-out rates, preferring to rely only on Mr. McCarren's experience. In any event, BNSF's increase in training expense for these two classes of new hires overstates the training expense, because, based on BNSF's own statement, those employees that drop out "generally go through about half of the training period before falling out." *See* BNSF Reply at III.D-127. Based on this statement, BNSF's inclusion of 100 percent of training expenses for drop-out candidates overstates the training expense BNSF incurs. BNSF also attributes the drop-out rate, in part to the *current* environment where hiring quality train crew personnel is very difficult, again ignoring that the TNR starts in early 2000 when the industry was laying off train crew personnel, not facing a shortage of personnel as they are today. In the 2000 environment, experienced train crew personnel were plentiful and the drop-out rate would have been far less than in today's environment. As such, the Board should reject BNSF's proposed drop-out additive.

Dispatcher Training. AEP Texas and BNSF also disagree with regard to the training of dispatchers. On Opening, AEP Texas based its dispatcher training on a railroad dispatcher program offered by Tarrant County College (“TCC”) in Fort Worth, Texas.⁶¹ This program provides for 14 weeks for training new dispatchers (including four weeks of classroom training and ten weeks of field training). The TCC website indicates that individuals who participate in the program are responsible for paying for their own tuition, room, board and travel expenses while learning to become dispatchers. The website also indicates that some railroads that hire TCC graduates reimburse the new graduate for their \$2,500 tuition cost when they become employed by the railroad. On Opening, AEP Texas included the tuition cost for the dispatchers, but did not include other related expenses which are borne by the aspiring dispatcher. *See* AEP Texas Op. at III-D-47 and Op. electronic workpaper file “TNR_OP_EXP.xls.”

Contrary to the published cost of the TCC, which BNSF helped to establish, BNSF includes not only the tuition cost for dispatchers, but also travel expenses, a salary, and fringe benefits, even though the subject individuals are not yet railroad employees. This is a clear overstatement in the cost of training that will be incurred by the TNR. On Rebuttal, AEP Texas continues to rely on the costs as described on the TCC website.

⁶¹ As stated in AEP Texas’ Opening Narrative, this dispatcher training program was established in conjunction with BNSF, which is headquartered in Fort Worth, and Johnson County Community College. *See* AEP Texas Op. at III-D-47 n.21.

Maintenance-of-Way Supervisors and Laborers. On Opening, AEP Texas included two weeks of training for maintenance-of-way supervisors and one week of training for maintenance-of-way laborers. On Reply, BNSF – without any explanation – extends the laborers’ training to two weeks, proposes that the TNR pay them their full salary rather than the 80 percent of salary paid to other employees in training, and adds a totally unexplained \$70 per individual to the hiring cost. Given BNSF’s lack of explanation or justification, on Rebuttal, AEP Texas continues to rely on the training cost per individual relied on in its Opening evidence.

Equipment Inspectors and IT Specialists. AEP Texas and BNSF agree on the course costs and weeks of training required for training equipment inspectors and IT specialists. However, to the extent that AEP Texas and BNSF have different salaries for these positions, they incur different wage and fringe benefit costs during the training period.

In summary, AEP Texas’ Rebuttal initial training and recruiting cost is \$14.8 million, compared with the \$22.5 million proposed by BNSF. As discussed in Part III-G, *infra*, AEP Texas amortizes this initial training and recruiting cost over a five-year period, rather than charging the entire start-up cost to the first year of operating expenses.⁶²

⁶² In addition, BNSF assumes that the TNR will replace employees at a rate of { } per year, purportedly based upon its own attrition rate. See BNSF Reply at III.D- (continued...)

(c) Investment Fees

Finally, BNSF contends that the TNR must pay a 4% fee to investment bankers for financing the initial construction of the TNR. *See* BNSF Reply at III.D-127 to 128. On the basis of a lack of support, the Board rejected this same argument from BNSF in *PSCo/Xcel* at 76; *see also* *TMPA* at 162; *WPL* at 107. Notably, the insufficient evidence that the Board described in *PSCo/Xcel* (*i.e.*, a verified statement from the President and Chief Executive Officer of Anacostia & Pacific, a private consulting firm), has been reduced in BNSF's current Reply evidence to a mere reference to a conversation between witness McCarren and this same executive (and the citation of a *Wall Street Journal* article). This evidence does not rise to the minimum level that the Board identified in the *PSCo/Xcel* decision; namely, "evidence of the existence and size of equity flotation fees associated with equity issuances of a similar size" *See PSCo/Xcel* at 76.

⁶² (...continued)

127. BNSF multiplies this amount by its inflated estimate of initial training and startup for a cost of approximately \$1.2 million for ongoing training and recruitment per year. BNSF, however, chose to ignore evidence submitted by AEP Texas on Opening that CSXT's attrition rate is far lower at 3%. *See* AEP Texas Op. Workpapers Vol. 18, p. 09081. AEP Texas sees no reason why the TNR would have a higher attrition rate than CSXT and continues to use 3% as in Opening evidence. Multiplied by AEP Texas' estimated training and recruitment costs, this results in a \$0.4 million cost in the base year.

d. Other (Information Technology Requirements)

The TNR's information technology ("IT") requirements, including hardware, software, personnel and outsourcing costs, were addressed in detail at pp. III-D-50 to 64 of AEP Texas' Opening Narrative. This evidence was sponsored by AEP Texas Witness Joseph Kruzich, who has extensive experience as a senior IT manager at several Class I railroads. *See* AEP Texas Op. at IV-37 to 39.

BNSF addresses the TNR's IT requirements primarily in connection with its discussion of the G&A staffing for the Finance and Accounting Department (BNSF Reply at III.D-76 to 79) and outsourcing (BNSF Reply at III.D-81 to 89). Mr. Kruzich responds here to BNSF's evidence on IT issues.

As Mr. Kruzich noted in AEP Texas' Opening IT evidence, the TNR is unlike any of the existing railroads to which BNSF compares it. The TNR handles only trainload movements – predominately unit coal trains. This fact greatly reduces the complexity of the computer systems required to support the railroad's operations and the performance of its managerial functions.

Computer system requirements are very complex for a typical Class I or regional railroad due to the large number of customers served, large number of commodities handled, thousands of different origin and destination pairs, different types of equipment required to handle the lading, the need for extensive yard operations to handle blocking and support local switching activities, the need to keep track of service

commitments to customers on an individual car basis, *etc.* The TNR's traffic consists predominantly of unit coal trains, with some overhead trainload traffic handled.

Unlike real-world railroads, the TNR has only a few customers, eight interchange points, predominantly one commodity, predominately private cars, service measurements entirely by train, no blocking requirements, and multiple-car billing with the RMI revenue system used to allocate revenues. This type of operation simplifies the information technology requirements enormously.

AEP Texas' Opening evidence clearly identified the basic needs for a computer system to operate and manage the TNR. BNSF proposes more elaborate computer systems, software, and personnel. In considering the differences between the parties' IT evidence, the question to answer is how elaborate the system needs to be to enable the TNR to operate safely, efficiently and provide adequate service to meet the needs of its customers (these are the essential tests of a SARR's feasibility).

i. Staffing

BNSF's Witness Reilly McCarren – whose Statement of Qualifications does not reveal any specific IT experience, either at a railroad or elsewhere – proposed that the TNR should add an Assistant Vice President to its IT staff because WCS and other railroads have one. BNSF Reply at III.D-76. Mr. Kruzich disagrees with the additional staffing and is confident that the staffing submitted on Opening (one Director and ten IT Specialists) is sufficient to meet the TNR's IT needs.

The fallacy in BNSF Witness McCarren's staffing and other IT assumptions is that he does not differentiate information technology needs between the TNR unit train operations and the operations of WCS and other railroads which handle numerous commodities, various car types, hundreds of customers, hundreds of origin and destination pairs, yard operations to handle blocking, *etc.* Nor does Mr. McCarren take into consideration the difference in the kind and volume of computer transactions processed by these railroads.

At the very least, WCS and the other comparison railroads would have several times more computer transactions to handle one carload from origin to destination than TNR given the latter's trainload operations. For the WCS and the other comparison railroads to handle a typical carload, a transaction would be created to process the shipper's car order, create yard blocks, assign a local or industry job to deliver the car to the customer, assign a local or industry job to pick up the carload at the customer's location, create a train block to the destination, create yard blocks at destination, and finally, assign a local or industry job to deliver the carload to the customer. For the typical TNR "carload," on the other hand, a transaction would be created to process the shipper's request for an empty unit train, assign a crew to place empty train at a shipper's site, and assign a train crew to pick up the train and to deliver the train to the shipper's destination or interchange point.

There is thus a significant difference between a railroad like WCS and the TNR in terms of the number of computer transactions required to handle a given carload. In designing a computer system (or a communications system), the number of transactions generated is the key variable in determining the requirements for the staffing, the size and type of computer equipment, the databases, the storage, and many other critical issues.

ii. Outsourcing/IT System Needs

BNSF's Witness McCarren also has suggested that the TNR and the WCS outsourcing environments are similar. To say that UP's Transportation Control System (WCS' outsource), is similar to the RMI Transportation Management System used by the TNR is completely mistaken. *See* BNSF Reply at III.D-81. UP's system is a very large, complex mainframe system that was designed to run a large Class I railroad, whereas RMI is an IBM AS400 mid-range computer system.

When Mr. Kruzich was CIO at the Kansas City Southern, KCS considered various outsourcing alternatives before deciding to develop an in-house transportation system. One of the systems that KCS considered was UP's Transportation Control System. KCS' review of that system revealed that it was a very old system, designed and coded in a very old computer language (Rails). KCS discovered that the system's main core is very old (developed in the sixties) with new technologies wrapped around the core to make it more user friendly. This makes the system very complex and expensive to maintain.

The RMI system, on the other hand, constitutes fairly new technology. It was designed in the 1980's primarily for short lines and regional railroads. It runs on an IBM AS400 mid-range computer, not a mainframe. It is much simpler, easier to use, and less expensive to maintain than UP's system, yet it has essentially the same capabilities insofar as the TNR's computing needs are concerned. Mr. McCarren obviously is unfamiliar with the RMI system, as it is incorrect to argue that an efficient SARR like the TNR would use the UP system with its mainframe environment rather than the RMI system.

BNSF also asserts that AEP Texas did not make clear in its Opening filing who will be responsible for the TNR's voice communication network. *See* BNSF Reply at III.D-78. This function will be performed by one of the ten technicians assigned to the IT Department. Each technician will have specific assignments. The voice communication network responsibilities will be assigned to the two network engineers (two of the IT technicians), as stated in AEP Texas Op. at III-D-63. The network engineers will be responsible for overseeing network security matters and local network-LAN/wide area network-Wan. These two positions will also be responsible for planning, designing, and managing transmission facilities, cabling and communications devices. These positions will also handle any telecommunications issues that may occur. This staffing is more than adequate to handle TNR's voice communications needs. While at the KCS, where the telecommunications system was much more complex than that of

the TNR, Mr. Kruzich supervised one lead person and one assistant that monitored the entire telecommunications voice system and the microwave system. The microwave system was outsourced to Comet Industries and the telephone system was controlled by the central switchboard at Kansas City, which handled over 2,600 miles of railroad and over 1,000 telephone installations throughout the KCS system. The same voice communications monitor and trouble shooting functions on the TNR can be easily absorbed by the network engineers due to the fact that TNR will only have approximately 100 telephones.

The primary function of the TNR's IT department is to provide desktop support, monitor communications, coordinate issues with RMI relating to the transportation, revenue and car hire systems, help desk activities, developing new systems and upgrade existing systems (two programmers) and other miscellaneous IT activities. It should be noted that the IT specialists are providing coverage twenty-four hours per day, seven days per week by one person each shift, with the remaining specialists on duty five days per week during normal business hours. BNSF's staffing plan totally ignored the simplicity of the TNR operations, and uses the WCS as a model for the TNR staffing conclusions. This totally ignores the fact that TNR will have significantly fewer transactions to process on a per carload basis than the WCS. Mr. Kruzich's staffing of one director and ten technicians is sufficient to meet the TNR's IT needs.

BNSF suggests that the principal shortcoming of the IT structure proposed by AEP Texas lies not in the staffing of the IT department but the absence of system support in key areas. BNSF Witness McCarren compares the AEP Texas proposal to a small Class III carrier with less than \$15 million in revenues. *See* BNSF Reply at III.D-81. He apparently believes that revenue is the only criteria in which to evaluate IT systems. He totally ignores the total number of transactions handle by a railroad such as the TNR with a predominately unit coal train operation as compared to a multiple commodity, car type, customers, origin and destination pairs, *etc.* carrier.

For example, a carrier that handles multiple commodity trains may only average \$1,000 per car which creates several transactions while the unit coal train may average \$40,000 per train with the same amount of transactions as the multiple commodity carriers for a single car in the train. There clearly is no comparison between a multiple commodity carrier and a predominately unit coal train carrier when it comes to determining IT systems.

Mr. McCarren also makes a comparison of the TNR's percent of revenues and expenses to WCS (a multiple commodity, car type, customers, origin and destination carrier) and claims that the IT annual expenses of the TNR (a predominately unit coal train operation) must be too low. *Id.* This revenue comparison is not valid because the mix of traffic handled by carriers can vary dramatically. For example, a carrier which handles a significant amount of intermodal carloads in its traffic mix has a lower revenue

per car handled than a carrier which has a significant amount of unit coal train in its traffic mix. This does not mean that one carrier's IT systems are more efficient than those of the other carrier, but instead, that traffic mix drives IT costs.

Mr. McCarren also compares the percentage of IT costs to total operating expenses (*id.*) to determine what the TNR's IT cost should be. This is a somewhat better basis for comparison than revenue, but it still is not valid. A carrier like WCS handles multiple commodities in its trains, numerous customers and many origins and destinations. A WCS train thus creates significantly more transactions than a TNR train. The TNR predominately handles one commodity in unit trains, and the cars in each train have only one origin and destination, one car type, a single customer, *etc.* These are the dynamics that drive IT cost, not percentage of revenues or expenses.

Even if one compares WCS ratio of IT costs to total operating expenses in 1999 of 3.2% to TNR's 1.9%, which is a 40.6% difference, it is still the case that the TNR's annual IT expenses are more than sufficient to cover all its IT needs for an efficient operation. *Id.* This is based on the fact that most of WCS' trains carry multiple commodities involving multiple origins, destinations and customers, which create hundreds of transactions per train. Again, the TNR has only one commodity and only one origin, destination, and customer in the vast majority of its trains – which means that each TNR *train* creates the same number of transactions as one *car* in a WCS train. Transactions drive IT costs, not revenues or expenses.

BNSF Witness McCarren also reports that he spoke with the VP-Marketing for RMI, which is the principal provider of operating systems software to regional railroads. According to Mr. McCarren, Mr. Piscidia estimated that annual IT expenditures of 2 ½% to 4% of revenues are typical for small railroads. *Id.* at III.D-81 to 82. This estimate, however, does not take into consideration the type of traffic handled by the carriers in question. When Mr. Kruzich spoke to RMI (approximately three years ago), RMI indicated that a railroad handling only unit coal trains would experienced much lower computer usage than a railroad that handles multiple commodities for numerous customers between many origins and destinations. In fact, Mr. Kruzich was told that the RMI cost per car set forth on the published RMI price schedule could be reduced significantly for an exclusively-unit train operation because a unit train operation creates far fewer transactions per carload than a railroad that handles multiple commodities with numerous origins, destinations and customers.

BNSF Witness McCarren consistently overstates the complexity of the TNR in an obvious attempt to drive up its IT operating costs. For example, Mr. McCarren states that the TNR should not use RailConnect, which produces items such as electronic bills of lading, because it does not offer the breadth of functionality offered by major railroad operating systems such as BNSF's TSS, UP's TCS or CN's SRS. *See* AEP Texas Op. Workpapers Vol. 18, pp. 09137-168 for a description of the RailConnect capabilities. Mr. McCarren is correct about RailConnect's functionality, but this observation is entirely

irrelevant because the TNR is not a 30,000 route-mile railroad in need of such functionality. The TNR has only 1,192 route miles and operates predominately unit coal trains (and only complete trains for its non-coal overhead traffic).

Mr. McCarren also states that RailConnect is not a system configured for a unit-train environment. *See* BNSF Reply at III.D-83. This is an amazing statement, and reveals a lack of knowledge about the manner in which IT systems function. A unit train runs from one origin to one destination with a possible interchange in between. This is a straight-forward operation compared to the operations of regional railroads that use this system and that serve numerous origins and destinations, commodities, hundreds of customers, *etc.* Yet, the RailConnect system is entirely suitable for their needs.

BNSF also states that the TNR requires a train planning and reporting module and a coal train forecasting module. *Id.* Mr. Kruzich agrees that the TNR needs some simple type of planning and reporting module to start with, and probably a coal train forecasting module in the future as volume increases. However, the TNR does not need to spend \$150,000 to purchase these systems because its IT staff has two programmers who are more than capable of developing these systems in-house. Mr. Kruzich estimates that it would take no more than 300 man-hours to develop the train planning and reporting module. These two programmers (3,696 man hours available per year) will later develop a simple coal train forecasting module for future TNR use. These systems

need not be as sophisticated as BNSF's systems, but instead, can be tailored to meet the specific needs of the TNR's narrower range of operations.

Next, BNSF claims that the TNR will be required to spend \$300,000 annually for outsourcing system development and replacement connected with its use of RailConnect. *Id.* at III.D-84. Mr. Kruzich disagrees with this assessment because it is too general and does not specify what project(s) would be outsourced. The TNR's IT staffing includes two full time programmers to handle all future development needs. Mr. Kruzich has provided for adequate funds in the TNR's IT budget to operate efficiently and to support the TNR's customer base. This is particularly true when one considers that the TNR will be predominately a unit coal train operation.

BNSF also claims that the TNR must acquire an elaborate maintenance-of-way system similar to the one currently in place on CSX. *Id.* at III.D-85. Mr. Kruzich disagrees with that assessment because the TNR is not the same type of operation as CSX, which has many times the route miles of the TNR. A simple PC-based reporting system is adequate to track maintenance-of-way activity. This reporting system will be developed by the TNR's Engineering staff with assistance from the IT programming staff. With only 1,192 route miles, the TNR simply does not require the kind of elaborate systems that BNSF describes.

BNSF also indicates that the TNR requires a car repair billing system, and suggests Wabtec and TMD as the provider of this system. *See* BNSF Reply at III.D-85 to

86. Mr. Kruzich disagrees with this suggestion because the TNR's car inspectors can use a standardized worksheet placed on a clip board to gather the necessary information. This worksheet data can then be inputted into a standard PC spreadsheet application to provide all the car repair billing information needed. This information can then be used by the Accounting department to issue the car repair bill to the appropriate party. This system is perfectly adequate because most of the cars used in the TNR's operations are privately owned cars.

BNSF also recommends that the TNR acquire a locomotive utilization and repair billing system. Mr. McCarren asserts that most large regional railroads have such a system (which means, of course, that there are also large regional railroads that do not have such a system). *Id.* at III.D-85. In any event, Mr. Kruzich disagrees that the TNR requires such a system because it represents an unnecessary cost that need not be incurred by an efficient railroad with only 1,192 route miles and a predominantly unit coal train operation. Even most of the Class I railroads treat locomotives assigned to unit-train operations separately from the rest of their fleets, assigning a particular type or types of locomotives suitable for unit-train coal service to a coal pool or to specific coal routes, whereas other locomotives move from origin to destination and are more or less randomly reassigned to another train. It would be inefficient for a railroad to break up a unit-train locomotive consist simply in order to permit the measurement of utilization.

Moreover, most railroads do not measure locomotive utilization in unit coal train operations because it is assumed that the locomotives are being fully utilized while assigned to this service. When Mr. Kruzich worked for the ATSF (one of BNSF's predecessors) in the early 1990's, he managed the railroad's measurements systems. Unit coal train locomotives were excluded from the measurement reports. ATSF measured cycle times for coal train, which can easily be done on the TNR by extracting information from RMI's TMS system. Unit train cycle time is an effective way of measuring locomotive performance and customer satisfaction.

As for billing for locomotive repairs, this can be accomplished in the same manner as the car billing process mentioned previously. Mr. Kruzich disagrees that a special locomotive repair billing system is required, or even feasible. There is no need for such a duplicative system.

BNSF notes that AEP Texas did not provide up-front costs for installing AEI readers on the TNR. *Id.* at III.D-86. The AEI readers will be installed by the TNR's maintenance forces as operations commence, which is what most other railroads do. There is no need to add a separate cost for the installation of AEI readers.

BNSF also states that TNR will be required to purchase the InfoRail system to monitor the testing and certification of railroad operating employees. *Id.* at III.D-86. Mr. Kruzich disagrees. Most railroads have their own internal systems for this function. This reporting system is not complicated, but is a straightforward tracking system. TNR

has sufficient IT staff to develop this system on a PC spreadsheet application. Indeed, when Mr. Kruzich assigned two programmers to the TNR's IT staff, it was for just this type of systems development. Again, BNSF ignores the fact that the TNR has an internal programming staff.

In another attempt to increase the TNR's IT costs, BNSF Witness McCarren claims that the MAS200 accounting system is not sufficient for the TNR needs. His conclusions are based on a conversation with Mr. Brian Wilson, Sales Representative at Best Software, Inc., which is the maker of the MAS500, MAS200 and MAS90 accounting systems. According to Mr. McCarren, Mr. Wilson indicated that for a company the size of TNR, the MAS500 system would be the best-fitting product of the three, and that his company normally does not recommend MAS200 for companies exceeding \$100 million in revenue.

It is not surprising that a sales representative for a software vendor would try to sell a more expensive product, and like most sales representatives, would be inclined to advocate the use of his most sophisticated product. The TNR, however, has outsourced its revenue accounting systems to RMI, which performs most of the accounting functions for the railroad. The MAS200 system is primarily used for accounts payable, accounts receivable, bank reconciliation, general ledger and timekeeping. The TNR has only a few customers, few vendors, less than a thousand employees, and most of its billing information exists on a trainload basis. Therefore, it does not need a highly

sophisticated system like the MAS500, notwithstanding the claims of the RMI sales representative regarding the benefits of a more expensive product.

Mr. Kruzich suspects that Mr. Wilson's recommendation was based on notions regarding a system that performs all accounting functions in a typical large corporate organization, and did not fully reflect the fact that the TNR's predominate accounting functions would be performed by RMI Revenue Management System with only general accounting functions performed on the MAS200 system.

BNSF Witness McCarren states that WCS used, and A&M uses, a similar product, MAS90. He also states that the capabilities of MAS90 were strained at WCS. Mr. Kruzich is not surprised by this, but notes that the TNR is not using the MAS90 system. TNR will be using MAS200, which is a much larger system. According to Best Software's publications, the MAS90 is designed for medium-sized business (with 10 to 200 employees) whereas the MAS200 is a 32-bit version of MAS90 for Windows that incorporates client/server technology to add new capabilities. This is an extremely consequential difference. If the MAS90 was "strained" on the WCS, the MAS200 would probably be the right fit for WCS. MAS200 is more than adequate to handle all of the TNR's general accounting functions.

BNSF has also updated the RailConnect modules to those currently published by RMI. When Mr. McCarren updated the RailConnect prices, he should have asked RMI to base the new prices solely on operating unit coal trains and other complete-

trainload shipments. Again, when Mr. Kruzich obtained the RMI price sheet in 2000 (which happens to be the TNR's first year of operations), RMI indicated that if a railroad's operations were exclusively or predominately unit coal train a large discount (20 plus percent) would be available because unit coal trains require much less in the way of computer resources than regular manifest and intermodal traffic. Also, the high volume of carloads would qualify for discounts as can be noted on the RMI price schedule. *See* AEP Texas Op. Workpapers Vol. 18, p. 09133. If anything, the TNR's cost for RailConnect is overstated by at least \$700,000 when considering the available discounts.

Finally, Mr. McCarren argues that a percentage-of-operating-expense approach is a better basis to judge the appropriate cost for the TNR's IT outsourcing because most IT activity is related to activities in other areas. *See* BNSF Reply at III.D-89. It is absolutely correct that IT activity is related to activities in other areas; this is exactly why the TNR can utilize less complex systems than real-world railroads like WCS or even KCS. As previously explained, those railroads require several times more computer transactions to handle one carload from origin to destination than the TNR, which is a unit-train operation. The TNR creates transactions for more than 100 carloads at a time, whereas WCS and other railroads create their transactions for each individual carload. This significant difference in the number of computer transactions required to

handle carloads between other railroads and the TNR is the primary reason why BNSF's approach to determining the TNR's IT costs is flawed.

It is illogical to use 3% of operating expenses as a criterion to determine the TNR's IT expenses. The danger in using a percentage of operating expenses is unintentionally demonstrated by BNSF Witness McCarren himself when he states that WCS' IT cost is 2.8% to 3.2% of operating expenses and that KCS's IT cost is 6% of operating expenses. Which percentage does one use? WCS and KCS are similar-sized companies and handle similar commodities, yet there is a 100% difference in their annual IT costs as a percentage of operating expenses. Mr. McCarren's conclusion that the TNR should expect to spend approximately \$7.9 million in total IT expenses annually, or \$10.52 million after BNSF's software and outsourcing additions, is totally unfounded and the Board should reject it.

AEP Texas Witness Kruzich has demonstrated that outsourcing to RMI and using a NT/PC/Client Sever for all other IT functions represents a feasible and viable solution for the TNR. All of the relevant costs have been adequately accounted for in AEP Texas' Opening evidence.

4. Maintenance-of-Way

On Opening, AEP Texas submitted an estimate of the total annual maintenance-of way ("MOW") costs for the TNR. These costs were based on a MOW plan that was developed by AEP Texas' expert MOW witnesses, William L. Krestinski

and Alan Blackwell, with input on operational and engineering issues from Paul Reistrup and Harvey Stone. AEP Texas' plan was premised on a newly formed, efficient railroad operating in a hypothetical world unencumbered by the vagaries of antiquated labor agreements, merger labor protective conditions, older equipment and facilities, constrained resources, and barriers to entry and exit. Consistent with SAC theory and precedent, AEP Texas also recognized that it was starting with new equipment and facilities, a new route structure and *defined* traffic volumes for the life of the SARR. Applying these principles, AEP Texas' experts concluded that the annual costs associated with its MOW plan would be \$81.6 million, of which approximately 34% (or \$27.9 million) would be assigned to operating expense.

In its Reply evidence, BNSF presents a remarkably different view of the annual MOW costs that would be experienced by the TNR. In support of this view, BNSF relies upon a plan developed by Mr. Gerald Albin, a former BNSF employee, to advance its claim that the total annual cost of maintaining the TNR, including costs for personnel, materials, equipment and outside contract work, would be \$144.1 million. Of this amount, BNSF attributes approximately 48% (or \$69.6 million) to operating expense, with the remaining 52% (\$74.5 million) attributed to capital expense. This plan is also endorsed by Mr. William J. Rennie, the Managing Director of Mercer Management Consulting, Inc. As discussed in more detail below, BNSF relies upon Mr. Rennie to question whether AEP Texas' plan is "realistic," and relies extensively on the practices of

“real-world” railroads without any apparent recognition or consideration of their differences with the TNR.

As explained more fully below, while BNSF is correct that SAC principles require that the TNR’s MOW plan be “feasible,” it incorrectly posits a standard for judging the parties’ respective positions on MOW expenses that assumes the SARR’s MOW requirements and practices will mirror those of the incumbent and/or other Class I railroads. This assumption reflects the further devolution of SAC theory as advanced by defendant railroads in recent SAC cases. On the contrary, SAC theory does not assume that a Class I railroad’s current mode of operations is representative of how a least-cost, most efficient yet feasible new entrant would approach issues such as MOW and other operating expenses.

As detailed more fully below, when the TNR’s MOW plan is considered under proper SAC guidelines and theory, it is evident that AEP Texas’ MOW plan for the TNR is indeed feasible, and that BNSF’s plan greatly exaggerates the staffing and equipment expenses that are required to maintain an efficient, newly constructed SARR with a defined prospective traffic base. Accordingly, as BNSF has not demonstrated that AEP Texas’ plan is infeasible, AEP Texas continues to believe that its MOW expenses are correct and should be considered as the best evidence of record for calculating this element of SAC. As summarized above, and in AEP Texas’ Opening Evidence, the

annual costs that should be assigned to MOW are thus \$81.6 million, of which approximately 34% (or \$27.9 million) should be assigned to operating expense.

a. BNSF's Critique of AEP Texas' Approach

BNSF begins its Reply with a lengthy critique of AEP Texas' MOW plan. BNSF Reply at III-D-131 to 163. Throughout this critique, BNSF perpetuates its mistaken notion that to be feasible, a least-cost, most-efficient SARR must mimic the practices of existing, unionized, inefficient "real-world" Class I railroads. On the contrary, it is important that the Board adhere to SAC principles and evaluate the MOW plan in the context of the hypothetical world in which the SARR operates – a world in which the roadbed and track structure are newly constructed, state-of-the-art facilities, and where the workforce is unconstrained by labor agreements and merger protective conditions that historically have hindered Class I railroads from achieving all of the efficiencies that are available. Thus, to the extent that any "real-world" railroad is to be used as a benchmark or other type of measure for what is feasible, it must be recognized that the TNR should be assumed, at a minimum, to be comparable only to the least-cost, most-efficient real-world operators. When considered under these appropriate standards, it is evident that BNSF's critique of AEP Texas' MOW plan is unfounded.

i. Staffing

The parties' principal area of disagreement on MOW expenses relates to their different approaches to staff requirements. AEP Texas estimated that the TNR's

MOW staffing requirements would cost approximately \$26.1 million on an annual basis. This staff is comprised of 150 employees (AEP Texas Op. Table III-D-1), including 30 managers/supervisors and 120 staff level employees. As explained below, unlike traditional Class I railroads, AEP Texas designed a system that assumes that only the most basic inspection and spot maintenance activities will be managed and performed by this staff – leaving all program maintenance activities to be performed by outside contractors.

BNSF suggests that the personnel costs should be more than double the amount estimated by AEP Texas, claiming that the TNR will need to spend \$54.4 million per year on MOW staffing. In support of this estimate, BNSF asserts that the TNR will need a MOW staff nearly 3.25 times larger than that proposed by AEP Texas, and presents a plan that assumes 488 employees, consisting of 36 managers/supervisors and 452 field workers.

In support of its inflated MOW staff, BNSF relies upon several misconceptions. BNSF Reply at III.D-133 to 163. Each of these misconceptions is addressed below.

**(a) AEP Texas’ Mow Plan Does Not Ignore
Necessary Activities and/or Random Outages**

First, BNSF suggests that AEP Texas ignores costs associated with real-world maintenance activities including “random failures” and other unexpected problems that can result in unscheduled maintenance. BNSF Reply at III.D-133 to 139. In making this sweeping generalization, however, BNSF offers no specifics as to which costs it

claims AEP Texas has omitted. Rather, BNSF's argument represents a fundamental misunderstanding of AEP Texas' approach in this case, as well as a gross mischaracterization of the impacts of random track outages on spot maintenance activities.

BNSF's claim that AEP Texas is "ignoring costs associated with real-world maintenance activities" is largely based on BNSF's apparent misunderstanding of how the use of contractors will isolate and limit the need for program maintenance. As explained on Opening, the TNR relies upon outside contractors to carry out the majority of program maintenance, which is included in the TNR's capital budget. Based on this reliance, AEP Texas developed a streamlined MOW staff that performs only basic (spot) maintenance functions, and looks to contractors to perform the remaining functions. BNSF disputes this approach and argues that AEP Texas' approach results in "productivity levels more than 500% greater than the most efficient Class I Railroad currently achieves." BNSF Reply Exhibit III.D.4-2 at 19.

BNSF's cavalier dismissal of the use of contractors to perform program maintenance, however, is not supported by any evidence that demonstrates that such outsourcing is not feasible for a SARR, or for that matter in the "real world" that BNSF cites so often. Indeed, the use of outside contractors in this manner has been a "real-world" solution for regional and shortline railroads that are not burdened by the corporate structures and labor agreements that have caused Class I railroads to be slow to recognize these solutions. For example, the September 2003 issue of *Progressive Railroading*

reports that Rail America, the world's largest short line and regional freight railroad operator,⁶³ relies on outside contractors to perform 95 percent of its capital maintenance work. As Rail America explained, the use of such contractors has enabled it to reduce its costs and provided other efficiencies: "now we pay only for work completed and there's competition for our work so we get great unit prices." See AEP Texas Reb. Workpapers Vol. 2, pp. 00685-695. As Mr. Krestinski attests, this approach and experience have been employed by large Canadian railroads, including Canadian Pacific and VIA Rail Canada. AEP Texas Op. at III-D-68 to 69.

One of the key reasons that regional and short line railroads, like Rail America, have been able to take fuller advantage of outsourcing than Class I railroads is the difference in labor arrangements. As recently explained by one commentator: "The regionals' contracts with their unionized workers permit greater flexibility in how employees are utilized, and more outsourcing of functions like track maintenance." Tom Murray, *A Different Way to Run A Railroad: Regional Versus Network Carriers*, Journal of Transportation Law, Logistics & Policy, (Spring 2004) at 300. See AEP Texas Reb. Workpapers Vol. 2, pp. 00696-705. The same is true for the TNR. TNR's workforce will

⁶³ According to its website, Rail America owns 47 short line and regional railroads, operating approximately 12,000 route miles in the United States, Canada and Australia, including track access. In North America, these railroads operate in 26 states and six Canadian provinces. See www.railamerica.com/about.html.

be nonunionized – thereby giving it greater flexibility than the incumbent to outsource functions like MOW.

BNSF’s critique also ignores and mis-states the benefits that cross-trained employees will bring to the TNR. *See* the discussion of cross-training at III-D-99 to 101 of AEP Texas’ Opening Narrative. Moreover, unlike BNSF, AEP Texas has in fact defined the components of its basic, spot maintenance. AEP Texas Op. at III-D-71 to 75. This work is defined as “day-to-day” and “infrequent/unplanned.” As to the former, AEP Texas has explained that the day-to-day work will be performed by five-person crews (one foreman, three track maintainers and one signal maintainer). AEP Texas provided a detailed listing of the types of tasks that each of these cross-trained crews is expected to perform in its maintenance district. *Id.* at III-D-72.

BNSF also asserts that AEP Texas’ plan understates MOW needs because of its failure to recognize that the continuous movement of heavy loads, as contemplated for the TNR, has a significant impact on the day-to-day maintenance activities required to keep the plant in safe operating condition. BNSF Reply at III.D-133 to 134.

Contrary to BNSF’s suggestion, AEP Texas does not fail to account for the relationship between traffic density and maintenance expense. On Opening, AEP Texas clearly stated that “while speed and tonnage handled are factors, they are not as significant as one might first expect since both have their remedy in program work more or less in proportion to the magnitude of each.” AEP Texas Op. at III-D-73. With this

concept in mind, AEP Texas designed a MOW plan that recognizes the distinction between the basic (*i.e.*, in-house, internal, spot) maintenance force and the program (external, outside contracted) maintenance resource. AEP Texas' MOW witnesses agree that the maintenance effort increases with traffic density, and that it is the *program* component which is more sensitive and needs to be more responsive to increases in speed and tonnage, and not the basic maintenance component.

As noted above, AEP Texas detailed the duties of the TNR's MOW staff on Opening. Each of the TNR's basic field MOW crews is capable of handling the duties listed over a section of the network roughly 65 route miles long. It is the nature of those duties that permits this size of basic maintenance work force to adequately attend to them whether the tonnage handled over the route is 30 MGT or 300 MGT per mile. The difference in speed and tonnage determines the frequency of program maintenance needed. The life of the infrastructure elements is reduced as a function of the increased speed and tonnage. Thus, rail, ties, ballast, track geometry and bridges deteriorate at variable rates and need replacement/restoration at different frequencies, depending on speed and tonnage, to maximize the asset life. None of these program activities is carried out by the basic force but rather by skilled outside contractors.

For example, at III.D-144 of its Reply Narrative, BNSF states that AEP Texas' plan to contract out track geometry testing, weed spraying, ultrasonic rail inspection, rail grinding, bridgework, and building maintenance "ignores the obvious

need on a railroad of this size for internal staff to handle the day-to-day responsibilities to grind, weld and build up frogs and switches, to repair crossings; to remove snow, ice and sand at switches and yards and other problem sites . . .” BNSF’s statements in this regard “ignore” the clear language of AEP Texas’ Opening evidence, which detailed some of the tasks assigned to its MOW crews, including:

- (1) effect welding repairs to frog/rail end/switch point;
- (2) remove snow from switches; and
- (3) flagging work at public crossings.

See AEP Texas Op. at III-D-72.

(b) Random Failures

In its effort to inflate the costs that should be attributable to operating expense for MOW activities, BNSF alleges that AEP Texas has ignored the impacts that unplanned occurrences or “random failures” have on the railroad’s operations. BNSF Reply at III.D-135 to 139. In support of this effort, BNSF states that there were more than 5,000 random outages in 2002 on the line segments replicated by the TNR, with an average duration of 2.5 hours per outage. *Id.* at 136. BNSF suggests that when a random failure occurs “an undesired restricted signal indication is displayed in the field and/or on the dispatcher’s board, for safety reasons a train must stop and wait at that location for authority from the train dispatcher before proceeding at restricted speed.” *Id.* at 137. The implication of this statement is that the failures were of a nature that actually caused the

trains to stop and wait for clearance. BNSF admits in a footnote, however, that “[i]n most cases, the train is not stopped for the duration of the failure.” *Id.* at n.129.

As detailed *supra*, at pp. III-C-38 to 54 and in Exhibit III-C-4, AEP Texas Witness Reistrup attests that BNSF is incorrect both in suggesting that AEP Texas’ MOW plan does not consider random track outages, and in overstating the significance of these events on both maintenance activities and general operations. Again, BNSF bases its conclusions on an assumption that flies in the face of SAC theory and precedent – namely, BNSF assumes that “as proposed tonnages on TNR are comparable to BNSF’s existing tonnage, the occurrences . . . are representative of the incidents that TNR could expect.” *Id.* at 136. There are many reasons why this assumption is incorrect, including primarily that BNSF has provided absolutely no proof of the extent to which any of the random outages it cites actually delayed train operations. These reasons are addressed in Part III-C, *supra*, and need not be repeated here. In sum, BNSF’s reliance on random track or signal outages as a basis to criticize AEP Texas’ MOW plan is without merit and does not provide a basis for finding that this plan is not feasible in any respect.

(c) Wood Ties

BNSF also claims that AEP Texas’ use of wood ties will “have direct consequence for the TNR’s future maintenance needs.” BNSF Reply at III.D-140, *citing* BNSF Reply Exhibit III.D.4-2. BNSF suggests that concrete ties are preferable, and that the failure to use concrete will result in unspecified (either by location or amount)

increases in the MOW activity relating to alignment, surfacing, gauge, and tie failure problems. *Id.* AEP Texas' MOW experts disagree that the use of wood ties provides a basis to conclude that their maintenance plan ignores costs. On the contrary, AEP Texas' experts believe that the use of wood ties is entirely appropriate given several concerns relating to the use of concrete ties that BNSF ignores, and that significantly offset the potential benefits that concrete ties arguably can provide. These concerns include:

- *Rail seat abrasion:* Concrete tie abrasion results when the material under the pad is lost to abrasion, hydraulic action and motion transmitted to rail. The loss appears in the form of localized breakdown of cement paste under the rail seat. This abrasion results in fastener fallout, running rail and wide gauge.⁶⁴ Each of these conditions can result in sun kinks in the rail and slow orders on the track.

Fastener fallout along with running rail can result in sun kinks due to the rail's not being fastened tightly to the ties. As the fasteners deteriorate, the rail is not clamped as tightly to the tie as it once was. This results in rail creep. Rail creep can result in sun kinks when temperatures rise into the 90's and 100's and the rail is not fastened tightly to the ties. Loose connectors can also result in wide gauge. As the gauge increases, the FRA guidelines require that slow orders be placed on particular track sections.

- *Accelerated rail wear:* Track lateral resistance tests performed on UP trackage by DOT's Facility for Accelerated Service Testing (FAST) have confirmed that use of concrete ties in heavy curvature can result in increased rail wear and problems with stability.⁶⁵ These problems can have

⁶⁴ Richard P. Reiff, Principal Investigator, Metallurgy and Civil Engineering, AAR Transportation Technology Center, AREA Volume 96, Bulletin 753, December 1995. See AEP Texas Reb. electronic workpaper file "Krestinski.pdf."

⁶⁵ Andrew Kish, Mgr. Guideways and Structures, USDOT/Volpe Centre, Dwight W. Clark, Director, Engineering Quality Management, Union Pacific RR, and William Thompson, Director, Methods and Research, Union Pacific RRR, AREA Volume 96, (continued...)

a direct impact on maintenance activities and refute any notion that the use of concrete ties would be preferable to the use of wood ties.

- *Maintenance*: Track managers/maintainers face significant practical problems when maintaining concrete tie track. Defective concrete tie replacement and disposal require resources far in excess of those needed for maintaining wood tie track.
- *Replacement*: When a concrete tie becomes defective, whether because of rail seat abrasion, tie pad failure, fastener fallout or cracking, requiring replacement, labor and equipment resources needed to remove an 800-pound tie are very significant. This work cannot be done manually, as would be the case with removal of a wood tie (which typically weighs approximately 180 pounds). The logistics of concrete tie supply, replacement and removal involve significant manpower and heavy equipment. On the other hand, two persons using hand tools are able to deliver the new tie, and replace and remove the defective tie.

In addition, replacement of concrete ties has a more direct impact on rail operations. In the event that an equipment-caused derailment (*e.g.*, a broken flange) occurs, ties are totally destroyed. Such events typically require taking the railroad out of service while the tie is replaced. Wood ties, on the other hand, can quickly be laced in and trains run, slowly until the repairs are completed. Accordingly, it is extremely risky to have concrete ties on the TNR, particularly on single track portions.

- *Disposal*: Wood ties are easily picked up and transported to either land fills or closed burning, energy producing facilities. Concrete ties, as noted, are significantly more difficult to handle because of their substantial weight. Disposal is thus far more difficult, and expensive, as it necessitates the use of additional manpower and/or heavy equipment. Equally problematic is the fact that, unlike wood ties, there is no readily available market for the disposal of concrete ties.

⁶⁵ (...continued)

Bulletin 752, October 1995. See AEP Texas Reb. electronic workpaper file "Krestinski.pdf."

In sum, while there may be some short-term benefits to the use of concrete ties, the negatives described above outweigh these benefits. Wood ties have a proven 180-year track record in North American railroad construction. They not only serve the user well, but their widespread placement in the railroad infrastructure demonstrates that they are maintenance/user friendly. Accordingly, there is no basis presented on this record to conclude that wood ties will have an appreciable impact on the TNR's MOW costs that would not be offset by the negatives addressed in this section. Moreover, BNSF offers no quantification or other evidentiary support that justifies the assumption that higher maintenance costs would be experienced by TNR because of its use of wood, rather than concrete, ties. Absent such proof, BNSF has not demonstrated that AEP Texas' MOW plan would be either infeasible or more expensive due to the use of wood ties.

ii. AEP Texas' Plan Adequately Accounts for Specific Needs

BNSF also claims that AEP Texas' MOW plan is deficient because it fails to account for certain geographic areas that present unique challenges to both construction and maintenance. BNSF Reply at III.D-140 to 141 and III.D-221 to 224. As discussed more fully in Part III-F, *infra*, AEP Texas has in fact accounted for these concerns in its construction design.

iii. AEP Texas' Plan is Adequate to Handle Routine as Well as Extraordinary Maintenance Occurrences

BNSF also attempts to discredit AEP Texas' MOW plan by arguing that the plan fails to recognize the impacts that heavy tonnage has on maintenance needs. BNSF Reply at III.D-141 to 151. In this section of its critique, BNSF presents the fundamental strawman to its entire analysis – namely: “[a]s TNR will carry greater tonnage than BNSF carries currently on the lines replicated by TNR, one would expect that TNR would experience greater maintenance requirements and thus would have greater staffing and equipment needs.” BNSF Reply at III.D-142. BNSF’s premise is that its own real-world experience is a minimum benchmark of what the SARR should be expected to experience – *i.e.*, BNSF suggests that there must be some correlation between BNSF’s MOW workforce and the TNR’s workforce – and assumes that the TNR’s workforce could not be more efficient.

Simply stated, BNSF’s assumption that as tonnage increases, MOW staffing *must* increase is incorrect. As Mr. Blackwell attested on Opening, the phenomenon of increasing tonnage and decreasing MOW operating expense is not new to the rail industry. Mr. Blackwell witnessed this very phenomenon on UP’s high-density coal routes in the mid-1990’s, during which UP substantially reduced the size of its MOW staff while at the same time triple-tracking and increasing volume on the busiest freight rail corridor in North America. *See* AEP Texas Op. at III-D-69 to 71.

BNSF is also wrong in claiming that “AEP Texas has ignored the performance of Class I railroads (including BNSF) in achieving the most efficient cost infrastructure in the world.” BNSF Reply at Exhibit III.D.4-2, at 23 to 25; BNSF Reply at III.D-164. BNSF further contends that AEP Texas has not identified any real-world high-density railroads that have achieved the cost structure proposed. *Id.*

BNSF’s self-serving anointment of itself as the “most-efficient” Class I railroad in terms of MOW is not supported by the evidence that has already been submitted in this case. Both Mr. Rennie and Mr. Albin completely ignore this evidence in making their claims. As reflected in the table below, when CP staffing levels for its busy Montreal-Toronto corridor are compared to BNSF’s proposed staffing levels for TNR, considering supervisory and non-supervisory track employees only,⁶⁶ Mr. Albin’s plan has twice as many employees per route-mile as CP:

TABLE III-D-26 Employees Per Route-Mile					
Railroad	Route Miles	Field Workers	Supervisors	Total	Route Miles/ Worker
BNSF’s TNR	1169	230	8	238	4.91
CP	174	14	2	16	10.9
Source for CP numbers: AEP Texas Reb. electronic workpaper file “Krestinski.pdf.”					

⁶⁶ This is the relevant comparison given that other functions of the TNR are being outsourced to contractors.

As this table demonstrates, AEP Texas has provided at least one real-world example of a large railroad that has achieved greater efficiencies than BNSF suggests are possible. Furthermore, Mr. Rennicke's suggestion that the TNR must be benchmarked against existing Class I railroads misses the point. The TNR *should* be expected to achieve greater efficiencies. As noted above, the TNR operates on new roadbed, with new trackage and facilities and is not subject to union work rules or merger labor protective conditions. The TNR also is moving a single commodity over most of its system in defined volumes over a specified life. None of the railroads used in Mr. Rennicke's benchmarking analysis operates under comparable conditions.

In addition, Mr. Albin's attempt to discredit AEP Texas' reference to CP's efficiencies because of a recent report of the National Transportation Safety Board ("NTSB") is unfounded. *See* BNSF Reply at III.D-147. BNSF claims that CP's MOW practices were somehow found "deficient" by the NTSB because of its report on a derailment that occurred on CP's lines. The NTSB report in question hardly can be characterized as the general indictment against CP's MOW practices that BNSF suggests. Rather, this report simply identified the probable cause of one derailment to have been a failure to "identify and replace cracked joint bars before they completely fractured and led to the breaking of a rail at the joint." *See* BNSF Reply Workpapers Vol. I, p. III.D-78. All railroads, including the BNSF, experience derailments that result from such conditions. The existence of these conditions in isolated instances of a maintenance

failure does not demonstrate that the overall maintenance approach is deficient – it simply indicates that there was a failure at this particular location. Accordingly, Mr. Albin’s reference to the NTSB report does not provide any basis to conclude that the reliance on CP’s overall maintenance practices is inappropriate, or that staffing the TNR to comparable staffing levels could not be feasible.

iv. BNSF Underestimates the Benefits of Cross-training

As with contractors, BNSF dismisses the benefits of cross-training with little discussion and no evidentiary support. BNSF Reply at III.D-151 to 153. Rather, BNSF simply concludes that cross-training will not work because of its claim that crews on heavy-tonnage railroads need to be specialized, and disputes AEP Texas’ suggestion that labor agreements have restricted BNSF and other Class I railroads from employing cross-training.

As AEP Texas explained on Opening, each of the TNR’s crews will be cross-trained and expected to perform multiple tasks. AEP Texas Op. at III-D-99 to 101. AEP Texas also cited Mr. Krestinski’s experience with short line railroads that have deployed cross-training successfully. For example, Mr. Krestinski noted that MOW forces on the Huron Central Railway, Quebec Gatineau Railway and VIA Canada Rail’s Alexandria/Smiths Falls Class 5 track network have all made use of cross-trained employees. *Id.* at III-D-100. AEP Texas further noted:

Track maintainers are able to inspect bridges and structures and effect minor repairs as needed. Signal maintainers assist

their colleagues with track repairs. Welders are similarly assigned to track repairs, delivery of materials, *etc.* All of the above employees are rules-competent, permitting their attendance to flagging requirements in accommodating not only work undertaken by railroad forces but by outside contractors.

Id.

AEP Texas also addressed BNSF's suggestion that large, heavy tonnage railroads cannot use cross-trained employees. As AEP Texas explained, the use of cross-trained employees is not a function of a railroad's size. *Id.* BNSF has offered no evidentiary support for a different conclusion here.

Equally unavailing is BNSF's claim that cross-training is unrealistic because of the skill level required to perform certain maintenance activities on a large, heavy tonnage railroad. Indeed, many of the activities that BNSF cites as requiring "crews that are skilled and specialized" relate to activities (such as track, bridge and signal work) that are primarily capital by nature and will be performed by outside contractors. It is true that a track maintainer will not be cross-trained to perform signal maintenance, but a track maintainer (or a signal maintainer, for that matter) can drive a hi-rail truck, assist in loading used ties into rail cars, *etc.*

In sum, BNSF's critique does not provide an adequate basis to conclude that AEP Texas' reliance upon a cross-trained MOW staff will not be feasible. Accordingly, AEP Texas submits that its reliance on cross-trained employees in developing its MOW plan for the TNR should be accepted.

v. **BNSF Has Grossly Overstated
MOW Equipment Expenses**

BNSF estimates that the TNR's total annual equipment expenses relating to MOW activities will be \$21.5 million per year. By contrast, AEP Texas estimates an annual budget of \$2 million for MOW related equipment. BNSF claims that this substantial difference is caused by AEP Texas' omission of certain allegedly key pieces of equipment, and too few pieces of equipment "for even its meager workforce." BNSF Reply at III.D-153 to 157.

On Opening, AEP Texas detailed the equipment requirements of its MOW staff. AEP Texas Op. at III-D-116 to 123. This equipment was broken out in detail in electronic workpaper file "SpotMaint.xls," tab "Equipment."

BNSF's inflated equipment costs can be readily reduced. First, \$7.7 million (or approximately 36%) of BNSF's \$21.5 million for equipment is attributable to program work, which will be outsourced by the TNR. Second, BNSF's equipment costs for both spot and program maintenance are substantially overstated and include costs not related to equipment that are accounted for elsewhere in the SAC analysis.

BNSF's MOW equipment costs are grossly overstated. This data includes line items for various types of equipment, annual field labor costs, annual field material costs, annual shop labor, annual shop material, fuel costs, and annual ownership costs. The data also includes a line item for the total annual cost, which reflects the cumulative total of all of the other line items. Essentially, by including all of these costs in the

equipment cost calculation, BNSF is double-counting for costs/expenses that are being accounted for elsewhere in BNSF's MOW and general operating costs. Review of recently produced supplemental BNSF workpapers (as contained in AEP Texas Reb. Workpapers Vol. 2, pp. 706-710) provides some telling examples of BNSF's overstatement of equipment costs:

- BNSF includes 13 "Tie Pluggers, Epoxy (PROD)" at a cost of { } per tie plugger. BNSF then adds { } in annual labor and materials costs to derive a total cost of { } for each tie plugger. Accordingly, approximately 88% of the "costs" BNSF includes for these pluggers are duplicative of costs recovered elsewhere in its SAC calculation.
- BNSF includes eight "Snow Blowers, Jet" at a cost of { } per snow blower. BNSF then adds { } in annual labor and materials costs to derive a total cost of { } for each snow blower. Accordingly, approximately 85% of the "costs" BNSF includes for these snow blowers are duplicative of costs recovered elsewhere in its SAC calculation.
- BNSF includes eight "Undercutters, Switch/Prod" at a cost of { } per undercutter. BNSF then adds { } in annual labor and materials costs to derive a total cost of { } for each undercutter. Accordingly, approximately 69% of the "costs" BNSF includes for these undercutters are duplicative of costs recovered elsewhere in its SAC calculation.

As these examples demonstrate, BNSF's Reply Exhibit III.D.4-1 significantly overstates equipment expense. When this overstatement is removed, total annual maintenance-of-way equipment costs are reduced from \$21.5 million to \$7.76 million (or by approximately 64%). Equipment costs attributable to annual operating expense are reduced from \$13.76 million to \$3,993,552 (representing approximately a 71% reduction). Equipment costs attributable to annual capital cost are reduced from

\$7.7 million to \$3,767,840 (representing approximately a 51% reduction). *See* AEP Texas Reb. electronic workpaper file “III D 4 Maintenance of Way excl equip operating cost.xls.”

Furthermore, even after stripping BNSF’s MOW equipment cost calculation of this inappropriate double-count, there remains significant overstatement in the equipment costs that BNSF assigns to annual MOW operating expense. As noted above, BNSF’s equipment costs are based on a MOW workforce that is substantially larger than is necessary for the TNR. Accordingly, even if one accepts that all of the equipment types suggested by BNSF are necessary, the quantities of these various types of equipment are nevertheless overstated.

In addition, some of the equipment that BNSF includes in its MOW operating expense is unnecessary because it is not needed for AEP Texas’ limited in-house spot maintenance activities. For example, BNSF suggests that AEP Texas has included “too few ballast regulators and speedswings.” BNSF Reply at III.D-155. With regard to the former, ballast regulators indeed were initially designed for handling ballast for purposes of filling empty track cribs and shaping the ballast shoulder in conjunction with rail, ballast, tie and surfacing programs. However, given their high cost, cost-conscious railroads soon found that they were also useful for snow removal in the off-season, with minor suitable modifications to the equipment. Under the AEP Texas plan, each of the three TNR maintenance districts will be equipped with one regulator

permitting adequate coverage of the territory. Many more regulators will be required to effect the program maintenance referred to above but these regulators will be provided by outside contractors as part of their required resources.

Speedswings are an invaluable piece of equipment for crews having a yard within their section limits. Hi-rail equipped, they can travel with ease by road or by rail and because they have high clearance over their wheels are able to cross over track infrastructure without the assistance of a roadway. Under the AEP Texas plan, each of two TNR MOW crews are so equipped and, in the event that a crew not having a speedswing requires the assistance of one, sharing will be arranged. As in the case of ballast regulators, speedswings will also be used in capital rail programs referred to above but these speedswings will be provided by outside contractors as part of their required resources.

BNSF has also overstated the number of speedswings that will be needed. BNSF suggests that speedswings will be necessary to allow crews to move heavy materials and equipment, and because they are “particularly adept at handling welded rail.” While AEP Texas agrees with this statement, it does not agree that additional speedswings would be necessary. As AEP Texas explained on Opening, the TNR uses speedswings only for yard activity, as the types of functions this equipment is typically used for will be performed by outside contractors or would be needed for activities that AEP Texas has clearly and appropriately defined as program maintenance. AEP Texas

Op. at III-D-122. For example, AEP Texas' spot MOW staff will not be handling welded rail. This function will be exclusively in the domain of program maintenance and will be carried out by production gangs managed by outside contractors.

Accordingly, BNSF has failed to demonstrate that AEP Texas' equipment costs are not feasible. The Board should reject BNSF's inflated equipment costs. At a minimum, however, the Board should strip BNSF's equipment calculations of the double-counts described above, and reduce the costs attributable to operating cost to \$3,993,552 (*i.e.*, the equipment cost that remains for spot maintenance after BNSF's labor and fuel additives are removed).

vi. BNSF Fails to Understand the Benefits of Outsourcing

BNSF's final criticism of AEP Texas' plan is that reliance on outside contractors does not make up for the alleged deficiencies in AEP Texas' MOW plan. BNSF Reply at III.D-157 to 162. While the parties' estimates of contract services are similar in scope and the total amount budgeted differs by only \$800,000 (BNSF Reply at Table III.D-4, representing the difference between BNSF's estimate of contract work costs at \$14.8 million and AEP Texas' estimate of contract work at \$14 million), BNSF contends that AEP Texas' reliance on contractors is inappropriate, given that it has allegedly understated the spot maintenance that should be performed by the TNR's in-house MOW forces. BNSF also asserts that reliance on contractors for some MOW operating expense work is not appropriate, based on its unsupported assertion that

contractors are unable to provide an adequate response time and may have difficulty retaining a qualified workforce. BNSF Reply at III.D-159 to 160.

SAC principles support the use of outside contractors. One of the key principles of SAC theory is the assumption that resources are available to the SARR on an unconstrained basis. *See, e.g., West Texas Utilities*, 1 S.T.B. at 668-670. Thus, in the MOW setting, the SARR proponent has the right to assume that contractors will be available, as will necessary equipment and labor to respond promptly. Given the scope of the contract work, it is reasonable to assume that any concerns about response time and a dedicated workforce would be minimal. As Messrs. Krestinski and Blackwell can attest, even an in-house workforce presents issues of response time. Crews are not always “on location.” The assumption that a dedicated contractor, or group of contractors, would not respond promptly when needed is illogical and unsupported by any evidence of record. Indeed, it has been the experience of AEP Texas’ MOW experts that contractors often are more responsive because they are not burdened by the numerous daily tasks and requirements that Mr. Albin assigns to his inflated MOW staff, as well as the event-driven maintenance activities that AEP Texas intends to staff with contractors. Thus, it is inappropriate for BNSF to discount AEP Texas’ reliance on contractors based on unsupported allegations that the contractors lack the resources to respond promptly to the TNR’s needs.

BNSF's criticisms of AEP Texas' contract assumptions for specified activities are equally unfounded. For example, BNSF suggests that AEP Texas relies on unrealistic estimates of building maintenance, communication inspection and spot maintenance, and bridge and culvert inspection contract costs. BNSF Reply at III.D-158 to 159. BNSF claims that AEP Texas has relied upon contract maintenance costs that do not include any recognition of the costs related to day-to-day activities that Mr. Albin claims require in-house workers. *Id.* at 158 to 162.

BNSF has failed to present any basis for concluding that AEP Texas' approach to outsourcing building maintenance is not feasible. Unlike existing buildings on BNSF and other "real-world" Class I railroads, all of the TNR's buildings will be newly constructed. In the short term, defects of construction are assumed to be covered by warranty. Other repairs/maintenance activities, such as window, door, plumbing and other repairs, can be very efficiently attended to by outside contractors. While BNSF and Mr. Albin state a preference to create an in-house staff to handle such matters, they have provided no evidence that the approach taken by AEP Texas is not feasible.

BNSF also disputes the assignment of spot maintenance on communications systems to outside contractors. *Id.* at III.D-159. Mr. Albin offers no explanation for his conclusion that trained in-house employees are preferable to outside contractors. The systems in question were not constructed by BNSF. Presumably, the same training provided to in-house workers for these systems is available to contractors – indeed such

training is typically provided by the very types of contractors that AEP Texas proposes to perform this function directly for the TNR.

Likewise, Mr. Albin's reliance on BNSF's purported internal costs to maintain its communications systems does not provide a barometer for what a least-cost, most-efficient SARR operating with newly constructed systems could expect. BNSF's costs reflect both its inflated labor component, as well as the fact that many of its communications systems have older equipment that requires further attention. In addition, review of the BNSF's Reply electronic workpaper file "III D 4 Communications Cost.xls." reflects labor and equipment costs that are duplicative of other costs included in BNSF's MOW labor and equipment expenses and should not all be attributed to spot (as opposed to program) maintenance of its communications system.

Equally dubious is BNSF's suggestion that bridge and culvert inspection and repair work cannot be outsourced without also retaining nearly 50 additional B&B employees. BNSF Reply at III.D-160 to 161. In support of this suggestion, BNSF offers the undocumented claim from Mr. Albin that "new bridges frequently presented some of the biggest challenges and problems." *Id.* at III.D-161. Mr. Albin offers no examples, nor does he explain the types of challenges and problems that have purportedly been experienced with the new bridges.

Also, it bears noting that for depreciation purposes, BNSF's accepted asset life of bridges and culverts is 74 years, except for bridge ties, **which is 21 years**. Unlike

the TNR, BNSF's staff has responsibility for inspection and maintenance of facilities of varying age, many of which are well advanced in their life cycle. By contrast, the TNR's bridges and culverts will be newly constructed. While BNSF dismisses this fact, it offers no evidentiary support for the conclusion that such new structures will experience any significant problems. As with new buildings, to the extent any construction-related defects are discovered, they would be the responsibility of the builder. As AEP Texas noted on Opening, bridge deck inspections and minor repairs will be performed by its MOW crews. AEP Texas Op. at III-D-85. Major work, including detailed bridge inspections and repairs necessitated by storms and/or derailments, will be contracted out. *Id.* at 86. Given the unique vintage of these bridges (*i.e.*, TNR will be the only newly constructed 1,000+ mile railroad), it is logical to expect that its structures will require less in-house attention than a more varied and older portfolio of bridge structures. BNSF offers no evidentiary support for its thesis that AEP Texas' approach is not feasible under these unique circumstances, and no "real-world" experience requires a contrary conclusion.

b. BNSF's Alternative MOW Plan Grossly Overstates Expenses

After providing its critique of AEP Texas' MOW plan, BNSF next turns to the presentation of its own MOW plan for the TNR. *See* BNSF Reply at III.D-163 to 224. In developing a plan that BNSF self-servingly characterizes as "realistic" and "based on a real-world view of the maintenance needs of a high tonnage railroad that is consistent

with railroad practices,” BNSF presents a plan that manages to incorporate all of the inefficiencies that plague real-world, unionized, highly specialized MOW Class I railroad departments. While AEP Texas does not dispute that it is regrettably “realistic” and “feasible” for a Class I railroad to have an inflated, over-staffed MOW workforce, such a plan hardly demonstrates either that AEP Texas’ plan is not “realistic” and/or “feasible,” or that the BNSF’s plan represents the best that a least-cost, most-efficient SARR could achieve operating under the SAC principles discussed above.

i. Personnel

Rather than representing a least-cost, most-efficient operation, Mr. Albin’s “bottom-up” approach to building a MOW staff appears to be nothing more than an attempt to duplicate BNSF’s staff structure. While Mr. Albin states that “BNSF did not simply adopt BNSF’s staff,” in the end the staff he develops is remarkably similar to BNSF’s. As reflected in the table below, the staff developed by Mr. Albin differs from BNSF’s staffing for the lines being replicated by a mere 10 employees.

TABLE III-D-27 COMPARISON OF "REAL-WORLD" STAFF TO BNSF's PROPOSED TNR PLAN			
Department:	TNR Field Workers:	BNSF Field Workers:	Difference:
Systems Engineering Office			
Track Department	230 + 48 (seasonal)	289	-11
Bridge & Building (B&B)	43	49	-6
Signals Department	72	73	-1
Communications Department	39	45	-6
Electrical Department	10	6	+4
Purchasing/Stores MOW Personnel	10	0	+10
TOTAL	452	462	-10

See BNSF Reply at III.D-167, Table III.D.4-5. As this Table demonstrates, BNSF has effectively presented a plan that mirrors its current staffing on these lines.⁶⁷

In essence, BNSF is suggesting that there is no fat, whatsoever, in the manner in which it currently staffs its MOW operations on the line segments the TNR is replicating. BNSF assumes that its current operations are the model of efficiency, and that a SARR operating with new roadbed, track, buildings, bridges and other structures would experience no benefit over a railroad that has a 100+ year old roadbed, that is comprised of facilities of widely varying ages, and that has a unionized work force.

⁶⁷ These staffing levels do not include production gang employees that will perform program maintenance. It appears that the above BNSF employees perform overlapping program maintenance duties in the course of their normal employment.

Review of BNSF's staffing plan reveals that there are many areas where BNSF has grossly inflated the TNR's personnel needs. Examples of these overstatements are as follows:

- Section Crews: BNSF's field personnel structure places oversight in the hands of the Roadmaster. This position is equivalent to AEP Texas' Field Maintenance Supervisor. BNSF's plan provides for section crews that report to the Roadmaster and are responsible for handling many of the same day-to-day activities that AEP Texas assigns to its section crews. The principal difference is that BNSF proposes a larger number of section crews because of the smaller crew districts BNSF assumes as compared with AEP Texas. BNSF assumes that each crew should be assigned 40 route miles, with crews on heavier density lines handling 35-40 route miles, and those on the medium density lines having as many as 55 route miles. BNSF Reply at III.D-184. AEP Texas has assumed that each of its crews will be responsible for territories of less than 60 route miles when the territory includes yard maintenance responsibilities, and between 65 and 70 route miles when there are no yard maintenance responsibilities. AEP Texas Op. at III-D-74.

As AEP Texas explained on Opening, there are several justifications for the size of its crew districts. The use of crew districts of this size is consistent with the practices of real-world short line, regional, and even Class I railroads. AEP Texas Op. at III-D-68 to 70. For example, AEP Texas noted that UP assigns only three 4-person crews

to cover approximately 200 miles of high-density main line in west-central Nebraska. *Id.* at III-D-70 to 71.

BNSF takes issue with AEP Texas' use of these real-world references because it claims that each of these railroads has additional field MOW employees and that using track maintainers as the only point of reference is misleading. *See* BNSF Reply at III.D-145 to 147. AEP Texas disagrees. Any difference in the number of additional MOW employees would have to consider the fact that many additional MOW functions on the TNR will be performed by contractors and are not within the spot maintenance duties that are to be performed by the TNR's section crews. BNSF conveniently ignores this fact in criticizing AEP Texas' reference to the comparable crew district sizes of other real-world railroads.

As to AEP Texas' reference to UP's experience, BNSF is incorrect in suggesting that AEP Texas has overstated the size of the territory covered by UP section crews in Nebraska. As confirmed by Witness Blackwell, who spent 16 years working on UP's high-density coal lines in MOW-related positions, BNSF arrives at its claim that AEP Texas overstates the territory covered by the UP section crews by basing its calculations on an incorrect assumption that the AEP workpaper it cites "shows that UP's three 4-person section crews cover a 120 route mile territory and not the 200 miles territory used by AEP Texas in its calculations." BNSF Reply at III.D-147 n.139. Review of BNSF's own workpaper, however, reflects that it is BNSF that has

miscalculated the size of the territory. *See* BNSF Reply Workpapers Vol. III, p. 0078. As reflected on this BNSF workpaper the UP South Morrill Subdivision referenced (*i.e.*, O’Fallons to South Morrill) is approximately 170 route miles. In arriving at its 120 mile calculation, Mr. Albin excluded the portion of this subdivision from Martin Bay south to North Platte, Nebraska (70 miles), and the portion of this subdivision from Gering north to O’Fallons, Nebraska (10 miles). *Id.* Measuring only between Martin Bay and Gering, Mr. Albin calculates 102 miles and then without explanation rounds the number up to 120. *Id.* In so doing, BNSF has understated the mileage shown (as rounded) on its own workpaper by excluding approximately 70 route miles that are properly considered part of the subdivision. Further, all of this territory is double-tracked. Accordingly, the track miles maintained by the section crews are easily more than 340 miles when sidings and yard tracks are considered. Thus, the 200 mile reference used by AEP Texas was extremely conservative.

Moreover, even if one accepts the inclusion of the non-track maintainer MOW employees in calculating the number of employees per route mile, as BNSF suggests, the numbers still reflect that AEP Texas’ plan is consistent with staffing levels employed by UP on this subdivision. As reflected in AEP Texas’ electronic workpaper “UP MOW Staffing.pdf,” two cost centers are listed on the gang worksheet for this territory. There are 24 employees assigned to cost center ED 661 who have responsibility for routine daily maintenance and inspection activities, including the 12 persons assigned

to the section crews. There are also seven employees assigned to cost center EC 673. These positions, however are extra-gang or on-line employees (*e.g.*, machine operators), who are not permanently assigned to the territory. These types of employees work on capital improvement projects and should not be considered in the context of spot maintenance activities. Even if one adds the additional 24 spot maintenance employees to the calculation, UP's staffing on this line is still more similar to the staffing levels contemplated by AEP Texas' plan, than to BNSF's staffing levels. UP's staffing equates to 13.33 track miles per section crew worker (*i.e.*, 320 miles ÷ 24 employees).

Further, given that many activities that BNSF includes within the spot maintenance responsibilities of its crews are considered program work by AEP Texas, the AEP Texas crews are responsible for fewer duties and it is thus feasible for them to cover a larger territory than BNSF crews.

- District Gangs: Mr. Albin includes 16 three-person district gangs to respond to major derailments, washouts and other significant track problems. These gangs have fewer members than the four-member section gangs, yet are expected to perform functions that are well beyond the capabilities of a three-person crew. Mr. Albin has not demonstrated that these gangs would be able to respond adequately to a major derailment or other larger track problem. While Mr. Albin has been critical of AEP Texas' assumption that such activities could be attended to by outside contractors, such contractors are in a far better position to provide the necessary resources to address such

issues. Accordingly, AEP Texas' reliance on outside contractors is not only feasible, but far preferable to Mr. Albin's suggestion that 3-person in-house district gangs could perform these functions.

- Welder/Grinder crews: On Opening, AEP Texas included one welding crew (welder and helper) for each Field Maintenance Supervisor's district. Mr. Albin assigns two crews, consisting of a welder and a welder's helper, to each roadmaster. This approach results in a territory of approximately 150 route miles per roadmaster, with each welder/grinder crew thus responsible for 75 route miles. Based on Mr. Krestinski and Mr. Blackwell's experience, one in-house crew per field maintenance supervisor should be sufficient to service a territory.

- Machine Operators: BNSF includes 43 machine operators, including 25 that are assigned to major headquarters and 18 that are assigned to minor locations. AEP Texas will require machine operators to drive trucks and operate small equipment (*e.g.*, drills, rail saws and rail grinders), as well as larger machines such as speedswings and ballast regulators. The level of complexity attending the operation of the various pieces of equipment is such that none is so complicated that the cross-trained crews will not be both familiar with and competent in their operation. A distinct class of machine operators, owning that particular craft which so permeates the BNSF design, is neither necessary nor appropriate for the TNR.

- Bridge and Building Personnel: As explained above, the need for B&B personnel is greatly diminished due to the fact that TNR's bridges and buildings are newly constructed. AEP Texas plans to maintain these structures through outside contractors. Given that such new structures should be virtually maintenance free (or under warranty), and there is no basis to assume, as BNSF does, that a full-time staff of 43 persons will be necessary to perform inspections and maintenance. The use of outside contractors for such functions is not only feasible, but is quite common even on Class I railroads.

- Signal Personnel: AEP Texas assumed that signal personnel would be responsible for 2,000 AAR signal units per maintainer. Mr. Albin assumes a standard of 1,000 AAR signal units per maintainer, thereby resulting in the need for twice as many signal maintainers. He also provides for six 3-person crews to keep "in good operating condition all wayside signals, crossing signals, hot bearing detectors, and power switches," as well as to attend to the signal work associated with track gangs. However, the responsibilities of these 3-person crews are duplicative of the signal maintainers who also are responsible for performing these same duties.

While it is certainly possible to pay for unnecessary employees, BNSF offers no justification for a conclusion that AEP Texas' standard of 2,000 AAR signal units per maintainer is not feasible. Equally unfounded is the suggestion that an

additional, duplicative 18 employees (representing the six 3-person crews) are needed on top of this already inflated staff.

- Communications Personnel: Through this component of his MOW staff, Mr. Albin introduces 41 additional unnecessary positions. Specifically, this staff consists of two supervisors and thirty-nine field workers to attend to communications, microwave equipment and radio repairs. AEP Texas has assumed that these functions could be handled by outside contractors and, accordingly, does not include a staff to perform these functions. BNSF offers no explanation for why the AEP Texas approach would not be feasible or why its inflated communications staff is necessary.

- Electrical Personnel: BNSF includes one supervisor and 10 electricians in an Electrical Department maintenance force. Again, BNSF offers no justification for a conclusion that entrusting these functions to outside contractors is not feasible. Instead, it includes these superfluous employees to maintain buildings that, as noted above, are newly constructed and far less likely to experience the types of maintenance conditions that are prevalent on BNSF when dealing with its more varied and aged building structures.

- Purchasing: Mr. Albin includes a staff of ten employees to attend to MOW purchasing activities. AEP Texas did not include a separate department for purchasing. Instead, AEP Texas assumed that the purchasing function can be handled by TNR's Field Maintenance Supervisors. As AEP Texas explained on Opening, these

employees are responsible for ensuring that all MOW employees are properly equipped to perform their functions properly. AEP Texas Op. at III-D-75. BNSF has offered no basis to conclude that such an approach is not feasible, given the limited size of the TNR's maintenance staff and the fact that program functions will largely be outsourced. Accordingly, there is no need to include ten employees in a separate purchasing department to purchase and handle materials used by the TNR's MOW forces.

- Engineering Office Staff: Mr Albin's proposal of a 20 person staff to administer the system engineering office also results in significant overstaffing. BNSF Reply at III.D-168. Much of this overstatement results directly from the failure to recognize the feasibility of outside contractors. For example, Mr. Albin includes a Manager of Manpower Planning (*id.* at III.D-177) and Manager Track Gangs (*id.*). Both of these positions, however, oversee work that AEP Texas would outsource and are therefore unnecessary for the TNR. Mr. Albin offers no basis for his conclusion that it would not be feasible to contract these functions out along with the related work.

In addition, Mr. Albin perpetuates BNSF's real-world antiquated approach to managing its MOW workforce by including highly specialized managerial/supervisory functions, even though a more focused management would clearly be feasible. For example, rather than entrust management/supervision over welding and work equipment to a single manager (*e.g.*, Manager of Welding & Work Equipment), Mr. Albin advocates the need for *four* separate positions: Manager of Welding/Rail Detectors/Grinding;

Supervisor Welding/Grinding; Manager of Work Equipment; and Supervisor/Work Equipment. Such specialization is neither necessary nor representative of what a least-cost, most-efficient SARR, like TNR, could feasibly achieve.

* * *

In sum, given BNSF's failure to recognize the efficiencies that can be obtained through outsourcing, cross-training, and release from oppressive labor agreements and merger protective conditions, the MOW staffing plan presented by Mr. Albin is riddled with overstatement and is not representative of what a least-cost, most-efficient SARR could achieve when considered under appropriate SAC principles. The presentation of such a bloated plan does not serve to discredit the more streamlined MOW plan presented by AEP Texas on Opening. Accordingly, the Board should reject BNSF's inflated staffing requirements and find that AEP Texas' plan as presented on Opening represents the best evidence of record.

c. Equipment Plan

Similarly, Mr. Albin's budget for spot maintenance equipment expense is also inflated. As noted above, this budget is overstated in two respects. First, BNSF includes various labor and operating costs in its equipment costs, even though these same costs are accounted for elsewhere in BNSF's SAC calculations. When this double-count is removed, BNSF's spot maintenance equipment costs are reduced by nearly \$10 million.

See III-D 180 to 185, *supra*. Second, BNSF includes more units of equipment than are necessary because it is matching the equipment to an inflated staff. *Id.*

d. Compensation

On Opening, AEP Texas noted that its salaries were comparable to those for Class I employees. These salaries included additives for meals (10%) and fringe benefits (33.9%). AEP Texas Op. at III-D-66. BNSF takes issue with AEP Texas' compensation levels, and substitutes BNSF's actual experience with regard to both salaries and additives. BNSF Reply at III.D-201 to 204.

BNSF's use of its own wage and additive levels to calculate compensation for the TNR's employees does not, in itself, provide any basis for the Board to conclude that the compensation levels used by AEP Texas are not feasible. Indeed, BNSF makes no attempt to demonstrate that such levels are not feasible, but just restates the compensation to reflect its own experience with a unionized and well-entrenched work force. Such evidence neither effectively rebuts the feasibility of the AEP Texas approach, nor demonstrates in any way what a least-cost, most-efficient SARR like the TNR could achieve.

e. TNR OE Contract Work

BNSF and AEP Texas agree on the nature of several activities that may be contracted out, but differ as to unit costs and frequency. BNSF addresses specific criticisms of AEP Texas' contract assumptions at BNSF Reply III.D-206 to 220. As

noted above, none of these criticisms has a material impact on the feasibility of the TNR's

MOW plan as developed by AEP Texas MOW experts:

- *Weed Spraying:* AEP Texas provides \$500,536 for weed spraying and \$100,000 for brush cutting/mowing for a total vegetation control cost of \$600,536. Mr. Albin is critical of AEP Texas for not discriminating between non-noxious and noxious weeds and for providing no support for costs of spraying brush and crossings. Notwithstanding these criticisms, BNSF provides for only { } for the same functions. On the other hand, BNSF proposes a budget of { } on vegetation control under bridges, and assumes the function will be performed by in-house staff. BNSF Reply at III.D-208 to 209. In so doing, however, BNSF fails to explain how this amount was derived. Accordingly, AEP Texas sees no basis to assume that its budget is not feasible.
- *Ultrasonic Rail Testing:* BNSF accepts AEP Texas' unit costs on ultrasonic rail testing, but disputes its standard concerning frequency. BNSF dismisses this standard that it claims is "purportedly based on CP standards," even though it includes no basis for concluding that this standard used by a capable Class I railroad is somehow not feasible. BNSF Reply at III.D-210. Indeed, this standard is embodied in CP's Standard Practice Circular (*see* AEP Texas Reb. electronic workpaper file "Krestinski.pdf") and has been carefully, and successfully, adhered to in the real world.
- *Rail Grinding:* Again, BNSF's quarrel with AEP Texas' rail grinding practices appears to be based on its rejection of the CP's experience as an example of a feasible approach to this issue. BNSF Reply at III.D-213. In developing the plan for rail grinding, Mr. Krestinski relied upon a standard that is reflective of what he has observed is used by CP, a real-world Class I railroad with proven success. In his experience, this level of grinding addresses the two-fold challenge of eliminating rail surface imperfections such as corrugation, spalling or gauge corner cracking, which can develop under normal traffic, as well as reshaping the rail head for optimal wheel/rail contact. The frequency that Mr. Albin espouses is unnecessary and wasteful in terms of both initial cost and decreasing asset life.
- *Track Geometry Testing:* Mr. Albin accepts AEP Texas' standard for track geometry testing, but contests its \$56 unit cost per mile for this item. BNSF

Reply at III.D-215. Mr. Albin relies upon a { } unit cost that is purportedly based on BNSF's actual costs. In support of this effort, Mr. Albin cites an agreement that he claims uses a {

}

Further, BNSF has included additional workpapers that do not justify the use of the { } unit cost cited by Mr. Albin. Review of BNSF Reply Workpaper Vol. III, p. 0216 shows that BNSF has experienced a track geometry testing of as low as { } per test mile. Although this workpaper notes that the cost of ownership of equipment is in the range of { } per test mile, as demonstrated *supra*, BNSF's "annual ownership cost" of equipment includes labor and fuel additives that are accounted for elsewhere in its SAC calculations. See AEP Texas Reb. Workpapers Vol. 2, pp. 00706 to 00710. In addition, Mr. Albin's use of the { } unit cost does not match the workpaper he cites, which shows a total unit cost of {

{ }, without any explanation of why he is adding { } to the unit cost. Accordingly, BNSF's own conflicting workpapers demonstrate that the AEP Texas' \$56 unit cost is feasible.

AEP Texas also disputes Mr. Albin's criticism that it is unreasonable to use the target production rate to calculate the unit cost because in the "real-world" track geometry crews are frequently interrupted by priority traffic. While AEP Texas understands that BNSF regularly favors its "priority trains" over coal trains and other trains, TNR would not be subject to this risk. With the exception of the south end of the TNR between Amarillo and Oklaunion, Texas, the TNR is essentially an all-coal railroad. Train frequencies on this section of the TNR are significantly less than points north of Amarillo. Thus, given the more homogenous nature of its traffic,

⁶⁸ BNSF provides the Supplemental Agreement in its reply workpapers, but does not include the original agreement.

the TNR should not have difficulty scheduling track geometry testing around its daily operations. Accordingly, BNSF has not demonstrated that AEP Texas' assumed unit costs are not feasible based on the concern about priority traffic.

- *Miscellaneous Outside Contracting:* Mr. Albin takes issue with AEP Texas' assumptions on miscellaneous outside contractors primarily as they relate to bridge and building maintenance. *See* BNSF Reply at III.D-216. AEP Texas assumes this work will be contract and will be limited, given the newness of its structures and the fact that any defects in construction would fall under the builder's warranty for an initial period of time. AEP Texas also assumes that using this approach will assure that cost will only be incurred when corrective action is necessary. By contrast, Mr. Albin's inclusion of a bloated staff of bridge and building maintenance workers that would be underemployed waiting for one of these new structures to fail.
- *Ditching:* BNSF accepts AEP Texas' standard for the quantity of ditching that would be required, but attempts to justify multiplying the unit cost by nearly 4 times. *See* BNSF Reply at III.D-218. BNSF's purported justification is based on an overblown explanation of the type of ditching that would be required, and essentially assumes that the work involved is virtually ditch reconstruction. AEP Texas' plan is based on the reality that ditching requirements will vary over the network and thus the effort and cost are also variable. Based on the experience of AEP Texas' MOW experts, AEP Texas does not believe that any adjustments are thus necessary.
- *Snow Removal, Derailment and Casualty Repairs:* BNSF disputes AEP Texas' inclusion of \$175,000 for snow removal and storm debris removal, and suggests alternatively the use of its system average cost to derive a total cost of { } BNSF offers no basis for the assumption that its system average cost is relevant to the line segments that AEP Texas is replicating. Use of this approach includes BNSF line segments traversing heavy snow territory in the Pacific Northwest, Idaho, Montana, North Dakota, South Dakota, Minnesota and Wisconsin that are not a part of the TNR. BNSF also ignores the fact that most of the TNR system is south and east of Pueblo, Colorado – *i.e.*, in regions of the country that incur less snowfall than could be expected in the BNSF's system average.

BNSF's use of a route-mile basis for snow removal costs is also inappropriate. Snow removal costs are driven by the number and size of places from which snow must be removed, which is generally yards, parking lots and lesser used set-out tracks and switches. As the TNR has only two yards, and most of the railroad is heavily traveled thereby reducing the need for special snow removal work, AEP Texas submits that \$150,000 per year is more than adequate for the limited facilities requiring this service.

- *Environmental Cleanup:* Mr. Albin disputes that AEP Texas' inclusion of \$80,000 for environmental maintenance and suggests that BNSF's actual experience has been approximately { } annually. BNSF Reply at III.D-219 to 220. BNSF offers no basis, however, to suggest that its own experience is truly representative of what a least-cost, most-efficient operator could achieve through careful compliance with environmental regulations and concerns. Instead, BNSF once again assumes that its own experience is the only evidence of what is feasible for the TNR to achieve. AEP Texas' MOW experts continue to believe that an efficient operator could perform more efficiently than BNSF and would not incur these excessive costs.
- *Surfacing:* AEP Texas included surfacing as an operating expense, whereas Mr. Albin treats the item as a capital expense. BNSF Reply at III.D-220. AEP Texas continues to believe it is more appropriate to treat this item as an expense.
- *Yard Cleaning:* Mr. Albin accepts AEP Texas costs for this item. BNSF Reply at III.D-220.
- *Special Maintenance Costs:* BNSF also claims that AEP Texas has not explained how it will address certain special maintenance problems relating to ballast fouling caused by coal dust, embankment stabilization issues and curve alignment and gauging problems. BNSF Reply at III.D-221 to 224. As explained below, AEP Texas' construction and MOW plan are adequate to address these concerns and to minimize their potential impact on the TNR.
- *Coal Dust:* AEP Texas has not specifically addressed the matter of coal dust, but its experts have accounted for it in the capital program. In its capital program, AEP Texas anticipates undercutting the equivalent of 48

miles of track annually to address matters of deteriorating ballast, as well as ballast fouled with coal dust. The program is flexible so that the work will consist of a mix of full track undercutting, shoulder undercutting and (off track) surface removal.

- *Stabilization* (including alignment and gauging on Crawford Hill): Recurring slope stabilization problems are largely attributable to construction inadequacies on the BNSF lines being replicated. *See* pp. III-C-41 to 42, *supra*. They are addressed in the initial construction of the TNR, thereby reducing recurring maintenance costs in the affected areas.

f. TNR Capital Maintenance-Of-Way

BNSF correctly notes that a portion of TNR's MOW expenses is attributable to capital expense. BNSF Reply at III.D-225 to 226. To develop these expenses, BNSF prepared a capital budget designed by Mr. Albin and detailed in BNSF Reply Exhibit III.D.4-1. While BNSF claims that these figures were developed "building from the bottom up," BNSF offers no details explaining how it determined the cost breakdowns as between program and capital expense. For example, as noted above, BNSF suggests that it will have separate "system production gangs."

BNSF further criticizes AEP Texas' plan to the extent it claims that AEP Texas has understated the need for work trains. BNSF Reply at III.D-225 to 226. BNSF claims that the TNR will need four work trains operating throughout the year and would assign an annual operating expense cost of \${ } and a capital cost of \${ } for this equipment.

The TNR has no need nor does it want to maintain excessive work trains that it would only use several times per year. Accordingly, it has included two small

work trains to distribute ballast and other materials, pick up used materials, *etc.*, and otherwise has assumed that its contractors will provide work train equipment for program work when it is needed. Accordingly, the additional work train expense advocated by Mr. Albin is not appropriate.⁶⁹

g. Summary of MOW Expenses

On Opening, AEP Texas concluded that, based upon the facts, experience and judgment of its engineering, MOW and operating experts, 66 percent of the TNR's total annual MOW expense (or \$53.7 million) constitutes program (capital) work, and 34 percent (or \$27.9 million) should be assigned to operating expense. By comparison, BNSF attributes almost half of TNR's total annual MOW expense to operating expense (48%, or \$69.6 million) and only 52 percent (or \$74.5 million) to program work.

BNSF claims that its allocation of expenses is conservative based on a comparison of the costs per route mile to maintain real-world railroads of TNR's density. BNSF offers no basis, however, to determine how this figure can be used to verify that the operating expense that it attributes to TNR in this case is representative of what a least-cost, most-efficient SARR operating without the typical constraints of a real-world railroad could achieve. The portion of MOW expense that is attributable to operating expense is the more critical component of the SAC analysis, and BNSF's evidence lacks

⁶⁹ AEP Texas addresses the TNR's work-train needs in more detail at pp. III-C-26 to 28, *supra*.

any basis to conclude that AEP Texas' allocation is not feasible or that it is necessary or appropriate to allocate nearly 50 percent of total annual MOW expense to operating expense.

AEP Texas submits that the Board's treatment of this issue in other rate cases provides guidance as to whether it is feasible to allocate 34 percent of the TNR's MOW expenses to the operating budget. These treatments present benchmarks that are truly comparable to the TNR – *i.e.*, they represent new competitors, operating with a new roadbed and track structure and unburdened by the inefficiencies of the incumbent. These cases demonstrate that AEP Texas' use of a 34 percent allocation for operating expense is comparable to the levels that have been accepted by the Board in past rate cases.

Indeed, in the predecessor rate- reasonableness proceeding involving the Oklaunion coal movement, the Board allocated maintenance expenses based on BNSF's suggested line-item allocations. Using BNSF's approach in this regard, the Board allocated 36 percent of total annual maintenance costs to operating expense. *West Texas Utilities*, 1 S.T.B.2d at 697-98, Table C-1. This allocation should be deemed feasible for present purposes as well.

Thus, even if one were to accept BNSF's inflated total annual MOW expense of \$144.1 million (which the Board should not), if this amount is allocated consistent with the law of this case, a proper allocation of that amount would be to attribute 36% (or \$51.8 million) to operating expense, with the remainder being

attributable to program work. Further, when the equipment expense is corrected to remove BNSF's double count, an additional \$9.8 million should be deducted from the operating expense budget, reducing the amount to no more than \$42 million.

5. Leased Facilities

The TNR's only leased facility is UP's line between Sterling and Union, CO, over which the TNR operates by means of trackage rights. BNSF agrees with AEP Texas' unit costs for use of this facility and applies the cost per gross ton-mile to its reduced traffic volume. *See* BNSF Reply at III.D-230 to 231.

On Rebuttal, AEP Texas continues to apply the cost per gross ton-mile used on Opening, applied to the Rebuttal traffic volume moving between Sterling and Union.

6. Loss and Damage

"BNSF accepts AEP Texas' formula for determining loss and damage costs for TNR" (*see* BNSF Reply at III.D-231) and applies it to its reduced traffic volume. On Rebuttal, AEP Texas applies the same L&D costs to its Rebuttal traffic volume.

7. Insurance

In its Opening evidence, AEP Texas explained that the TNR would follow the standard practice of large railroads to self-insure against potential liability except for catastrophic risks, and that the TNR would obtain insurance at competitive rates to cover catastrophic loss and federal Employers Liability Act exposure. *See* AEP Texas Op. at III-D-127. On the basis of this approach, AEP Texas calculated the insurance expense for

the TNR by using BNSF's 2000 insurance ratio of 2.94 percent of operating expenses.

See AEP Texas Op. electronic workpaper file "TNR_OP_EXP.xls."

This procedure has been accepted by the Board in several recent SAC proceedings, including *FMC*, *Wisconsin*, *TMPA*,⁷⁰ and *PSCo/Xcel*. The Board's most recent pronouncement on this subject is found at page 83 of the recent *PSCo/Xcel* decision:

Xcel calculated the insurance expense – 3.48% of total operating expenses – based on BNSF's 2001 Annual Report R-1. For this case, BNSF acquired a much higher insurance quote from a private-sector insurance company. Xcel's evidence is used here, as it is supported by BNSF's own experience as well as evidence showing that certain shortline railroads have insurance costs in the 3% to 4% range.

On Reply, BNSF rejected AEP Texas' estimate of insurance costs, and instead engaged in a complex series of arguments to inflate that cost. *See* BNSF Reply at III.D-231 to 235. The Board should reject BNSF's estimate, and instead should follow the approach advocated by AEP Texas, which the Board has endorsed repeatedly, and which utilizes the same BNSF insurance figure that BNSF itself accepted in *TMPA*.

⁷⁰ In the *TMPA* case, the complainant and BNSF itself agreed upon the use of the same 2.94% figure that AEP Texas utilized in this case. *See TMPA* at 106 ("The parties agree that insurance expense can be estimated by multiplying operating expenses by 2.94%.").

a. BNSF's Revenue Distinction Argument

BNSF first contends on Reply that the TNR lacks sufficient revenues to be treated in the same manner for insurance purposes as the “largest” Class I carriers. *Id.* at III.D-232. According to BNSF, “[l]imited resources and investor demands require smaller carriers to self insure at much lower levels, approximately \$5 million” and that as a result, “smaller carriers pay more in insurance and casualty costs as a percentage of their expenses than larger carriers do.” *Id.* BNSF’s argument is inconsistent with available facts.

For example, under BNSF’s strictly revenue-based theory, tiny Providence & Worcester (P&W) with only \$22 million in revenues in 2001 should bear a proportionately larger burden than Kansas City Southern (KCS) with more than \$560 million in 2001 freight revenues. In fact, this is not the case. KCS’s 2001 insurance was 7.0 percent of operating expenses whereas P&W’s was 3.8 percent, nearly the same as BNSF’s. *See* AEP Texas Reb. electronic workpaper file “Other RR Insurance.xls.”

In addition, BNSF’s own statistics demonstrate the invalidity of BNSF’s purported distinction between the largest Class I carriers and other Class I carriers. In its analysis of Casualties and Insurance Cost per 1,000 GTMs for 2001, BNSF indicates that Soo had lower costs than NS. *See* BNSF Reply at III.D-233.⁷¹ However, BNSF’s evidence regarding railroad revenues for 2001 confirms that the Soo’s 2001 revenues

⁷¹ In its discussion of G&A expenses, AEP Texas demonstrated the dubious nature of BNSF’s consideration of SARR expenses on a gross ton-mile basis.

were less than ten percent of NS's. *See* BNSF Reply at III.D-42 (\$6.2 billion for NS and \$561 million for Soo). Consequently, it is evident that the strict revenue basis that BNSF identifies for insurance costs is invalid, and that the TNR should not be precluded from obtaining insurance at the same rate as BNSF.

Interestingly, in the predecessor *West Texas Utilities* proceeding, BNSF's predecessor itself argued that the Board should accept insurance evidence based upon the ratio of insurance expense to total expenses (less depreciation) from its own 1994 R-1. The Board accepted this argument, and rejected the complainant's estimate based on insurance quotes for short-lines railroads. *Id.*, 1 S.T.B. at 695 ("We cannot accept an insurance estimate based on short-line railroad experience. There is no evidence to suggest that these short-line railroads perform similar operations to those that would be performed by the WTRR. . . We accept BN's ratio because it is based on the operations of a major railroad, and we apply it to our restated operating expenses.").

BNSF's strictly revenue-based assumption also ignores the actual risk factors against which insurance is intended to protect a railroad and on which insurance rates are based. The greatest risk against which a railroad seeks to be insured is a catastrophic accident involving a derailment or collision (particularly collisions involving at-grade crossings) or an accident involving hazardous materials. BNSF faces a far greater risk of such incidents than the TNR faces because of the simple, repetitive nature of the TNR's operations. In addition, hazardous materials on the TNR represent only { } of all non-coal traffic, while { } of BNSF's non-coal traffic (*i.e.*, { }).

times the level of the TNR) was HAZMAT in 2001. *See* AEP Texas Reb. electronic workpaper file “Compare TNR BNSF Hazardous.xls.”

Moreover, the TNR operates largely in isolated portions of the country where the risk of collisions at grade crossings (for example) is significantly reduced compared to the totality of BNSF’s operations which include many large urban areas. The TNR handles intact trains, does not conduct local switching, and does not conduct significant yard operations. In addition, there are no tunnels on the TNR’s system.

Finally, BNSF’s argument also contradicts considerable rate case precedent in which the Board has accepted insurance ratios far *below* the TNR’s ratio of 2.94% for SARR’s with revenues that are comparable to the TNR’s 2001 revenue of \$767.3 million. *See, e.g., Duke/NS* at 63, 85 (accepting a 2.5% insurance ratio for a SARR with 2002 revenues of \$487 million); *Carolina* at 53, 72 (accepting a 2.5% insurance ratio for a SARR with 2002 revenues of \$454 million); *Duke/CSXT* at 50, 71 (accepting a 2.5% insurance ratio for a SARR with 2002 revenues of \$497 million).

b. BNSF’s Various Insurance Methodologies

Following its flawed discussion of the purported relationship between insurance expense and annual revenues, BNSF presents three separate calculations of insurance expense for the TNR. These include: (i) a “bottom up” estimate developed by the affiliate of BNSF’s expert of \$23.9 million; (ii) a “revenue-based” survey of insurance costs for various transportation service companies yielding a figure of \$17.4 million; and (iii) an “operating cost-based” analysis Class I carriers with less than “\$1 billion of

expenses (sic)” yielding an estimate of 5.49% of costs or \$19.7 million. Although BNSF claims inaccurately (and misleadingly) that it has chosen the “lowest estimate of casualty and insurance cost,” BNSF actually selects the higher operating cost-based estimate of \$19.7 million for use in this case. *Id.* at III.D-234 to 235.

As an initial matter, AEP Texas notes that BNSF’s “bottom up” insurance estimate includes the \$750,000 per year of Directors’ and Officers’ insurance that BNSF identifies without elaboration at p. III.D-69 of its Reply evidence. In addition to the fact that BNSF offers absolutely no support for its determination of this figure,⁷² it is evident that BNSF has selected an insurance calculation methodology that is not based on this “bottom up” approach. Consequently, any questions regarding the validity or reasonableness of this figure for purposes of the “bottom-up” insurance calculation are moot.

Nevertheless, the Board should observe that BNSF has included this \$750,000 annual figure in its calculation of G&A compensation, thus reflecting a blatant double-count of insurance costs. *See* BNSF Reply electronic workpaper “OPR_EXP.xls,” tab “Summary,” line 309. The Board should reject the inclusion of this amount as a portion of the TNR’s salary cost since BNSF itself has elected to refrain from following

⁷² BNSF’s narrative includes a citation to an electronic workpaper, but that workpaper merely sets forth the \$750,000 figure and lacks any text in its explanation section for that entry. *See* BNSF Reply electronic workpaper file “G&A Charts.xls,” tab “Mercer Cost of Risk Estimate.”

the “bottom up” approach to developing insurance costs. In that regard, BNSF’s alternative insurance calculations (and AEP Texas’ insurance calculation) are insurance estimates that are comprehensive in nature. It would be entirely improper to accept one of those comprehensive figures but also to add a separate insurance charge to the TNR’s costs.

As to the merits of BNSF’s insurance costs, BNSF’s claim regarding its selection of the lowest estimate of insurance costs is misleading for several reasons. First, after explaining its highest-cost “bottom-up” approach, BNSF sets up two additional insurance ratios, one that is revenue based and one that is cost based. However, BNSF presents the results of those two approaches using inconsistent inputs. Specifically, BNSF presents the outcome of the revenue-based analysis (*i.e.*, \$17.4 million) using AEP Texas’ higher estimate of the TNR’s revenues and BNSF presents the outcome of the cost-based analysis (\$14.5 million) using AEP Texas’ lower estimate of the TNR’s costs. BNSF then concludes that the cost-based approach is more conservative because \$14.5 million is lower than \$17.4 million, but BNSF then increases this “lower” figure to reflect BNSF’s higher operating cost estimate to arrive at an insurance figure of \$19.7 million, which of course, substantially exceeds the \$17.4 million estimate.

Had BNSF chosen to use its “higher” revenue-based approach, it stands to reason that it would have reduced this figure to reflect BNSF’s own revenue estimate. The resulting figure – based on BNSF’s own methodology and BNSF’s own reduced

revenue estimate – would have been \$14.9 million (*i.e.*, \$22.7 per \$1,000 of revenue multiplied by BNSF’s revenue estimate of \$654.6 million). This figure would have been \$4.8 million lower than the figure that BNSF has presented to the Board in its evidence as the least-cost alternative.

As stated above, Mr. McCarren performs an expected cost of risk analysis that produces a cost of insurance of \$22.70 per \$1,000 of revenue. The analysis is based on a report titled *Casualty Cost of Risk 2003* prepared by Marsh, Inc. (“Marsh Report”). BNSF characterizes this report as based on a survey of 23 different industries, including 40 transportation service companies. *See* BNSF Reply at III.D-234.

Review of the Marsh Report reveals numerous fatal defects in Mr. McCarren’s analysis. First, the 40 transportation companies are not identified even as to the type of transportation service companies that are represented. The reader does not know if the companies are railroads or taxi cab companies, trucking companies, airlines or ocean carriers.

Second, the largest component of Mr. McCarren’s cost of risk is auto liability which represents \$10.76 or 47.4 percent of the \$22.70 per \$1,000 of revenue. *See* BNSF Reply electronic workpaper file “G&A Charts.xls,” Sheet “Cost of Risk data.” For the TNR, with \$749.4 million in revenue, this translates to \$8.1 million⁷³ annually for auto liability insurance or \$62,025 per year for each of the TNR’s 130 motor vehicles.

⁷³ $(\$749,366,771/1,000) \times \$10.76 = \$8,063,186$

The Marsh Report shows that the average liability cost per motor vehicle for companies that own between 101 and 250 vehicles is only \$1,640,⁷⁴ far less than the effective \$62,025 per motor vehicle used by Mr. McCarren. Using the average amount per vehicle times the TNR's 130 vehicles, rather than Mr. McCarren's \$10.76 per \$1,000, yields an auto liability cost for the TNR of \$213,200 annually or \$0.28 per \$1,000 of the TNR's \$749.4 million in revenue.

Third, Mr. McCarren's worker's compensation component is incorrect. Based on the Marsh report the cost per \$1,000 for workers compensation is \$9.66 for companies with revenues between \$201 million and \$500 million annually and the cost for companies with revenues between \$501 million and \$1.0 billion annually is only \$0.44 per \$1,000 in revenue.⁷⁵ Mr. McCarren's analysis sums these two costs to yield a workers compensation cost of \$10.10 per \$1,000 of revenue. As the TNR has \$749.4 million in revenue, the correct number from the Marsh Report to be included in Mr. McCarren's analysis is \$0.44 per \$1,000 in revenue, not \$10.10 per \$1,000.

Correcting Mr. McCarren's \$22.70 per \$1,000 of revenue cost of risk calculation to reflect the appropriate amounts for workers compensation and auto liability

⁷⁴ See AEP Texas Reb. Workpapers Vol. 2, p.00715. Based on the average cost per vehicle of \$1,640 and the \$8,063,544 annual liability insurance amount developed by Mr. McCarren, this would indicate that the company reflected in his analysis has 4,917 vehicles. Clearly, this does not represent a railroad with \$749.4 million in annual revenue. This is another indication that the transportation service companies included in the Marsh survey are not railroads.

⁷⁵ See AEP Texas Reb. Workpapers Vol. 2, p. 00715.

insurance produces an overall cost of risk for the TNR of \$2.53 per \$1,000 of revenue or a total expense of \$1.9 million, or \$5.8 less than the \$7.7 million included in AEP Texas' Opening evidence.

AEP Texas, of course, rejects each of the various insurance methodologies described in BNSF's evidence and rejects BNSF's overstated costs and understated revenues. Nevertheless, AEP Texas submits that BNSF's own evidence confirms that BNSF has selected an obviously inflated means of calculating TNR insurance costs.

In any event, the Board should reject BNSF's insurance analysis because BNSF has not shown that there is a reason to use Class I carriers with less than \$1 billion in revenues instead of BNSF itself for purposes of bench-marking the TNR's insurance costs.

8. Ad Valorem Tax

AEP Texas estimated ad valorem taxes for the TNR in the states of Wyoming, South Dakota, Nebraska, Colorado, Oklahoma and Texas at \$4.4 million in 2000. The calculation of ad valorem taxes reflected an adjustment to exclude tax on road equipment because the TNR will not own its locomotives and railcars. *See* AEP Texas Op. at III-D-128. BNSF objects, without explanation, to the exclusion of taxes on road equipment. *See* BNSF Reply at III.D-235.

AEP Texas's exclusion of ad valorem taxes on leased equipment is warranted for two reasons. First, it is consistent with the Board's decision in *TMPA*. *Id.*

at 17. Second, AEP Texas' Witness Burris spoke with Mr. Bill O'Brien, a representative of CIT Group's Rail Resources Team, which is very active in leasing railroad rolling stock. Mr. O'Brien, indicated that, when negotiating a lease for rolling stock, the party that pays the property taxes is determined in negotiations. Further, it is CIT Group's experience that the lessor is most frequently responsible for paying the property taxes.

9. Other - Costs Related to Rerouted Traffic

The TNR handles some internally re-routed coal traffic, consisting primarily of originated coal traffic that the TNR interchanges to BNSF at Alliance, NE. AEP Texas presented evidence showing that although the re-routing results in some mileage increases, depending on the particular movement involved, the TNR's annual operating expenses reflect all increases in mileage-related costs resulting from the re-routes. AEP Texas also demonstrated that although some customers would incur some increase in car-maintenance costs which are mileage-related, the increased costs are minuscule, totaling a mere \$0.003 per ton in 2002. *See* AEP Texas Op. at III-D-128 to 129. BNSF did not respond to this evidence (*see* Reply at III.D-235) so AEP's evidence stands undisputed as the only evidence of record on re-routed traffic costs.

**III-E Non-Road Property
Investment**

III. E. NON-ROAD PROPERTY INVESTMENT

Neither AEP Texas nor BNSF presented any substantive evidence for this Part, which relates to leased equipment. Equipment is treated in other parts of the parties' SAC evidentiary presentation, and lease costs are treated as operating expenses for purposes of the DCF model. Accordingly, the Board should consider eliminating this part of its outline for the presentation of evidence in SAC rate cases.