

AUG 6 2004

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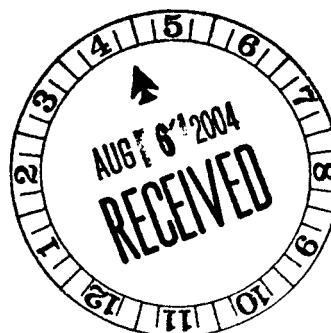
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August 6, 2004

211752

VIA HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Room 711
Washington, D.C. 20423-0001



Re: Docket No. 41185, *Arizona Public Service Company and PacifiCorp v. The Burlington Northern and Santa Fe Railway Company*

Dear Secretary Williams:

Enclosed for filing **UNDER SEAL** in the above-referenced proceeding please find an original and sixteen copies of the Brief on Reopening of Complainants Arizona Public Service Company and PacifiCorp (collectively "APS/PacifiCorp"). Also enclosed are an original and sixteen copies of the Public Version of APS/PacifiCorp's Brief on Reopening.

An extra copy of the Brief on Reopening also is enclosed. Kindly indicate receipt and filing by time-stamping this copy and returning it to the bearer of this letter.

Thank you for your attention to this matter.

Sincerely,

C. Michael Loftus
Attorney for Arizona Public Service
Company and PacifiCorp

CML/jwp
Enclosures

cc: Samuel M. Sipe, Jr., Esq.

211752

**PUBLIC VERSION – CONFIDENTIAL AND/OR
HIGHLY CONFIDENTIAL INFORMATION HAS BEEN REDACTED**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

ARIZONA PUBLIC SERVICE COMPANY,
and PACIFICORP,

Complainants,

v.

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY,

Defendant.

Docket No. 41185



ENTERED
Office of Proceedings

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**BRIEF ON REOPENING OF COMPLAINANTS
ARIZONA PUBLIC SERVICE COMPANY AND PACIFICORP**

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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
ARGUMENT	3
I. BNSF'S ADJUSTMENT OF THE REVENUES IN THE DCF ANALYSIS TO RECOVER REPARATIONS FOR PRE-MAY 2003 SHIPMENTS IS PRECLUDED BOTH BY LAW AND BY CONTRACT	3
A. The Prescribed Rates in Effect through May 21, 2003 Cannot be Challenged	4
B. BNSF's Attempt to Recover Reparations for the January 1999 through December 31, 2002 Period also Violates Contractual Commitments	5
C. Consideration of Actual Revenues Belies BNSF's Claimed Revenue Shortfall	7
II. BNSF'S PURPORTED INCREASE IN THE MINIMUM ANNUAL VOLUME APPLICABLE TO THE PRESCRIBED RATES IS IMPROPER	7
III. THE SCOPE OF REOPENING DOES NOT PRECLUDE THE INCLUSION OF NON-MCKINLEY TONS PRIOR TO 2007	10
IV. BNSF'S EXCLUSION OF TONNAGE FOR FUTURE TIME PERIODS IS UNFOUNDED	13
V. APS/PACIFICORP'S INFLATION FORECASTS ARE THE BEST EVIDENCE OF RECORD	14
CONCLUSION	15

seeks to do this by simply adding these amounts to the rates that are produced by the updated DCF analysis for the May 22, 2003 through 2008 period. For the reasons explained by APS/PacifiCorp in their rebuttal filing (APS/PacifiCorp Reb. Arg. at 5-12) and revisited briefly below, BNSF's effort to collect additional revenues for the services provided from and including 1994 through May, 2003 is precluded both by law and by contract.

There are several other issues that are addressed herein. These issues include the minimum annual volume commitment and associated penalties that BNSF's December 26, 2002 Common Carrier Pricing Authority 90069 purports to impose on APS/PacifiCorp's coal traffic moving under the rates prescribed by the Board in its *1997* and *1998 Decisions* in this matter. This new volume requirement is both inconsistent with the Board's Decisions establishing the prescribed rates and unreasonable on its face. Although APS/PacifiCorp had hoped it would not be necessary for the Board to deal with this issue,² circumstances require that the Board do so.

Additional issues relate to the unduly restrictive view BNSF has adopted of the scope of the evidence permitted under the Board's decisions reopening this matter and other improper attempts to exclude coal volumes and/or revenues from the SAC analysis.

(*"1997 Decision"*), modified *Arizona Pub. Serv. Co. et al. v. Atchison, T. & S.F. Ry.*, 3 S.T.B. 70 (*"1998 Decision"*). The May 2003 and October 2003 Decisions in this proceeding are referred to herein as the *"2003 Decisions."*

² See Reply to Petition to Reopen and Vacate Rate Prescription, at 9 n.5 and Sauvageau V.S. at 6; Complainants Arizona Public Service Company's and PacifiCorp's Opening Evidence and Argument on Reopening, Nordlander V.S. at 15.

ARGUMENT

I. BNSF'S ADJUSTMENT OF THE REVENUES IN THE DCF ANALYSIS TO RECOVER REPARATIONS FOR PRE-MAY 2003 SHIPMENTS IS PRECLUDED BOTH BY LAW AND BY CONTRACT

The purpose and effect of the adjustment made by BNSF to the DCF analysis in order to correct what it describes as a “conceptual flaw” in APS/PacifiCorp’s DCF analysis is very clear. This adjustment is designed to recover the present value difference between the maximum rate levels for the 1994 to May, 2003 period produced by: (a) the Board’s 1997 and 1998 DCF analysis; and (b) an updated DCF analysis based on the limited factors the Board has permitted the parties to address on reopening. In the words of BNSF’s Witness Baranowski, APS/PacifiCorp’s DCF revenues for 1994 through May 2003 are based upon “payment by APS of issue traffic rates at the level calculated . . . [under the updated DCF analysis] but APS in fact has paid the generally lower rates calculated and prescribed by the Board in its *1998 Decision* for the elapsed period.” Baranowski V.S. at 11. Stated simply, BNSF contends that because the Board set the prescribed rates too low in its *1998 Decision*, it should make up for that fact now by allowing BNSF to recover the additional revenues it should have been permitted during the “elapsed period.” *Id.* BNSF thus seeks reparations for the shipments that moved under the Board’s prescribed rates up until the time the Board lifted its rate prescription and imposed its keep account arrangement in the *May 2003 Decision*.

The reason why BNSF concocted this “adjustment” is also very clear. Without it, BNSF cannot come anywhere close to justifying the rates it wishes to impose on APS/PacifiCorp’s McKinley to Cholla traffic. Even if the Board were to accept all of BNSF’s other erroneous positions on reopening, its evidence would call for a rate very close to that calculated by APS/PacifiCorp for 2004 and rates actually lower than those

calculated by APS/PacifiCorp for 2005 and 2006. *See* Letter from Linda S. Stein to David M. Konschnik dated July 20, 2004, at Exhibit 1.

At the outset, it must be noted that BNSF has not, to date, even attempted to present any legal support for its unprecedented adjustment. This necessarily means that APS/PacifiCorp are deprived of any opportunity to respond to whatever such arguments BNSF may now present in its brief.³

A. The Prescribed Rates in Effect through May 21, 2003 Cannot be Challenged

The reparations BNSF seeks are directly and explicitly precluded by the Supreme Court's decision in *Arizona Grocery Co. v. Atchison, T. & S. Fy.*, 284 U.S. 370 (1932) ("*Arizona Grocery*"). The Supreme Court ruled in that case that the Board's predecessor, the Interstate Commerce Commission ("ICC") did not have the power to "... retroactively repeal its own enactment as to the reasonableness of the [first] rate it prescribed." *Id.* at 389. The Supreme Court further explained that:

If that body sets too low a rate, the carrier has no redress save a new hearing and the fixing of a more adequate rate for the future. It cannot have reparation from the shippers for a rate collected under the order upon the ground that it was unreasonably low. (*Id.* at 387-88).

Arizona Grocery is dispositive of this issue and requires that the Board reject BNSF's reparations claim. In fact, BNSF has previously acknowledged the Board's lack of authority to permit recovery of additional amounts on shipments that moved under prescribed rates, and the Board has previously disallowed any challenge to

³ Although the Board's July 2, 2004 *Decision* setting the briefing schedule reminds the parties that "new evidence is not permitted in briefs," it does not address potential sandbagging of this nature.

the prescribed rates for the elapsed period. *See* APS/PacifiCorp Reb. Arg. at 9-10. In rejecting BNSF's request for retroactive relief from prescribed rate levels in effect prior to this reopening, the Board ruled that "[h]ere, the lawfulness of the rates approved and prescribed pursuant to 49 U.S.C. 10704(a)(1) in our 1998 Reopening cannot be challenged with respect to traffic that moved from 1997 until now." *May 2003 Decision*, at 8; *see also* Docket No. 41191, *West Texas Utilities v. Burlington N. and Santa Fe Ry.*, (STB served May 29, 2003) at 6-7.

BNSF's proposed adjustment to the DCF Model would directly violate this precedent. As BNSF readily acknowledges, this adjustment is a device that is designed to recover pre-May 2003 shortfalls through the imposition of higher rates on post-May 2003 shipments. The fact that BNSF would recover these amounts prospectively does not change in any respect their undisputed nature. Indeed, only by giving retroactive effect to the new maximum rates can one even calculate BNSF's adjustment. Not only does this attempt run counter to *Arizona Grocery* and Board precedent, it also violates the well-established "rule against retroactive ratemaking" in other regulated industry contexts, under which courts have found that "[a] rate designed to recoup past losses is retroactive and illegal." APS/PacifiCorp Reb. Arg. at 11-12, *citing Public Serv. Co. of N.H. v. FERC*, 600 F.2d 944, 958 (D.C. Cir. 1979) and *Associated Gas Distributors v. FERC*, 898 F.2d 809, 810 (D.C. Cir. 1990).

B. BNSF's Attempt to Recover Reparations for the January 1999 through December 31, 2002 Period also Violates Contractual Commitments

BNSF's DCF adjustment should also be rejected because it violates the contractual arrangements between the parties for shipments during the January, 1999 through December 31, 2002 time period. APS Reb. Arg. at 12-14. {

} . If BNSF is allowed to recover “shortfalls” for the pre-May 2003 time period through higher rates for the post-2003 time period, the Board will be allowing it to {

} . APS/PacifiCorp Reb. Arg. at 14, *citing* Docket No. 42059, *Northern States Power Co. Minnesota D/B/A/ Xcel Energy v. Union Pacific R.R.*, (STB served May 24, 2002) at 1 n.1; Docket No. 42038, *Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Ry.*, (STB served May 11, 1999) at 1 n.1.

BNSF was well aware when it entered BNSF-C-12203 that there was a possibility that reopening of the 1998 rate prescription might be necessary because of future conditions at the McKinley Mine. {

} . *See*
APS/PacifiCorp Reb. Arg. at 14-17. {

} The same provision further states that:
{

}

MOU, Art. IIB. At the time BNSF {

}. APS/PacifiCorp Reb. Arg. at 14-17. In its

Petition to Reopen, filed August 18, 1997, BNSF stated, *inter alia*, that:

. . . the substantial reparations award and rate prescription that the Board seeks to impose on Santa Fe *today* are almost entirely driven by the Board's unsupported and clearly erroneous estimates of *future* traffic levels . . .

Id., at 2-3. See APS/PacifiCorp Reb. Arg., at 15-17.

**C. Consideration of Actual Revenues
Belies BNSF's Claimed Revenue Shortfall**

As explained by APS/PacifiCorp in their Rebuttal filing, if actual revenues on the traffic moved by BNSF to APS/PacifiCorp's Cholla plant and the other plant (Coronado) served by the AGRR stand-alone railroad are considered, there is no "revenue shortfall" for the pre-May 2003 period. APS/PacifiCorp Reb. Arg. at 17-19. BNSF's shortfall analysis is also flawed due to its improper exclusion of over { } million tons of coal delivered by BNSF to APS/PacifiCorp's Cholla Plant. *Id.*

**II. BNSF'S PURPORTED INCREASE IN THE MINIMUM ANNUAL
VOLUME APPLICABLE TO THE PRESCRIBED RATES IS IMPROPER**

The annual volume requirement set forth in the tariff that APS/PacifiCorp challenged through their 1994 Complaint in this matter was 1.5 million tons. See *1997 Decision*, 2 S.T.B. at 370. The Board's *1997* and *1998 Decisions* did not alter this minimum volume requirement, which therefore became part and parcel of the prescribed rate. BNSF's Common Carrier Pricing Authority 90069, however, purports to establish a significantly increased minimum volume obligation of 3.5 million tons per calendar year:

The STB prescribed Freight Rate applicable to Coal shipments shall be subject to a Minimum Volume of 3,500,000 Net Tons per Calendar Year. In the event that the Minimum Volume is not shipped, a Tonnage Shortfall shall exist. In the event of a Tonnage Shortfall, Shipper shall pay BNSF a Balance Due equal to the difference between \$14,735,000 and the total amount otherwise paid by Shipper for transportation service provided pursuant to this Common Carrier Pricing Authority.

See APS/PacifiCorp Op., Exhibit _ (KSN-5), at 2. The introduction of this new minimum volume conflicts with the *1997 Decision* and for this reason alone must be rejected by the Board.

In addition, BNSF's new minimum volume obligation also is inapplicable by its own terms. Specifically, BNSF's Pricing Authority 90069 provides that "[t]his Minimum Volume provision shall not apply to coal shipments moving under the BNSF proposed Freight Rate." *See* APS/PacifiCorp Op., Exhibit _ (KSN-5), at 2. As such, this volume term applies only to tons moving at the "STB prescribed Freight Rate." The Board's *May 2003 Decision*, however, removed "the prescriptive effect of the prior rate order" *Id.* at 8. Accordingly, the only rate to which the 3.5 million ton volume term could apply – by its very own terms – no longer exists.

APS/PacifiCorp also note that BNSF made no attempt to justify this heightened minimum volume in its Reply submission. Moreover, BNSF also did not include any shortfall penalty charges in the reparations calculations it has submitted in its April, 2004 Reply Evidence on Reopening, notwithstanding the fact that 2003 volume levels did not meet the purported minimum obligation. *See* BNSF Reply at Baranowski V.S., Exhibit _ (MRB-3), page 3, line 10, col. 6; *id.* at Baranowski V.S., Exhibit _ (MRB-4); *id.* at Murphy V.S., Exhibit _ (JAM-4), page 1, line 1, col. 10.

Even assuming, *arguendo*, that BNSF's modification to the minimum volume requirement were not precluded (a) by the 1997 and 1998 Decisions, (b) by its own terms, and (c) by BNSF's failure to reflect penalty revenues in its SAC calculations, the volume shortfall penalty itself also should be rejected as an unreasonable service term. As written, Pricing Authority 90069 requires APS/PacifiCorp to pay the full price for every ton of coal not shipped, rather than being set at a level that reflects the actual "harm" that would be experienced by BNSF (*e.g.*, the difference between its variable costs per ton and the rate charged). This amount is clearly penal in nature, as it has no relationship to any harm that might be experienced by BNSF in the event that APS/PacifiCorp's annual tender did not meet the new minimum volume obligation. *See, e.g., Techworld Hotel Associates, LLC v. NCS Pearson, Inc.*, 2003 WL 21664165 (D.D.C. 2003); *Red Sage Ltd. P'ship v. Despa Deutsche Sparkassen Immobilien-Anlage-Gesellschaft MBH*, 254 F.3d 1120, 1129 (D.C. Cir. 2001); *Mega Constr. Co., Inc. v. United States*, 29 Fed Cl. 396, 502 (1993); *Kingston Constructors, Inc. v. Washington Metro. Area Trans. Auth.*, 930 F. Supp. 651, 656 (D.D.C. 1996); *Corbin on Contracts*, at § 1063. As such, this provision is unreasonable and unenforceable as a matter of law.

Furthermore, BNSF's attempt to impose a minimum volume commitment that is at or higher than the volumes that have moved, and are projected to move, from the subject origin in recent years is clearly inappropriate.⁴ Traditionally, minimum volume requirements are set *below* the volume levels that are expected to be shipped, thus providing some minimum guaranteed level of shipments yet recognizing that some

⁴ *See, e.g., Nordlander R.V.S.* at 7, showing deliveries from McKinley to Cholla of less than 3.5 million tons in each year since 1995.

flexibility is required. BNSF's establishment of the minimum *at* a level that *exceeded* the level of shipments for the prior year (*i.e.*, 2002) was patently unreasonable. *See Nordlander V.S.* at 7.

Finally, the minimum volume limitation should be rejected because BNSF's attempt to alter the rate prescription in this regard is beyond the scope of reopening. The Board's *2003 Decisions* indicate that the goal of this action was to "maintain the status quo while we recalculate the maximum reasonable rate," not to expose APS/PacifiCorp to the arbitrary imposition of new charges and penalties. *May 2003 Decision* at 7. BNSF's attempt to radically change the minimum volume assumption is inconsistent with the Board's admonition that "the reopening must be limited to the basic assumptions upon which Arizona based its SAC case in 1994." *May 2003 Decision* at 5. As noted above, that analysis was based on a tariff with a 1.5 million ton minimum volume commitment, and any change of that assumption would be beyond the scope of this reopening.

III. THE SCOPE OF REOPENING DOES NOT PRECLUDE THE INCLUSION OF NON-MCKINLEY TONS PRIOR TO 2007

BNSF rejects the inclusion of non-McKinley tons prior to January 1, 2007 relying on the Board's statement: "we therefore need a more developed record on how Arizona and Salt River will re-source their coal needs, once McKinley shuts down, what portion of that traffic could flow over the SARR, and what revenues the SARR could reasonably expect to earn from that coal traffic." *May 2003 Decision* at 5. In so doing, BNSF takes the phrase "once McKinley shuts down" completely out of the context of the remaining language of the *May 2003 Decision*, and relies on that phrase to exclude over { } million tons from APS/PacifiCorp's DCF Model. *Crowley R.V.S.* at 21, Table 5.

The Board's 2003 *Decisions* include several statements confirming the validity of APS/PacifiCorp's inclusion of replacement coal in its SAC model to make up for declining tonnages of traffic moving from McKinley for the pre-2007 period and to update forecast assumptions relied upon in the Board's 1997 and 1998 *Decisions* that have proven to be inaccurate. APS/PacifiCorp Reb. Arg. at 20-31. These statements include:

- *The decline in traffic moving over the SARR from the McKinley Mine can be made up for by including in the SARR replacement coal from the Lee Ranch Mine, or even origins farther away, as crossover traffic that the SARR would interchange at Defiance. May 2003 Decision at 5 (emphasis added).*
- [T]he parties may update the record regarding *any forecasts* made in our prior decisions, such as inflation indexes, cost of rail equity, and revenue forecasts for the Salt River traffic, that proved to be inaccurate. *Id.* at 5-6 (emphasis added).
- Both parties may also update the record regarding *any forecasts used in the original SAC analysis that have since proved to have been inaccurate*, but they may not reargue or recalculate the base figures to which the forecasts applied. *October 2003 Decision at 3 (emphasis added).*

Accordingly, the Board's 2003 *Decisions* contemplate the inclusion of the non-McKinley tons that are described in APS/PacifiCorp's evidence. The statement that the "decline in traffic" from the McKinley Mine could be "made up for by including in the SARR replacement coal" from other origins, clearly covers the inclusion of replacement coal that is attributable to the gradual reduction of production at McKinley and the need for APS/PacifiCorp and Salt River to adjust to that decline. Interpreting the 2003 *Decisions* as allowing inclusion only of coal shipped after the shutdown of McKinley is not only in conflict with this statement, but would be entirely unfair and

unreasonable. The Board's *2003 Decisions* also clearly permit corrections to the volumes forecast by the Board in its *1997* and *1998 Decisions*.

Non-McKinley tons considered in APS/PacifiCorp's evidence include replacement tons purchased in the years 1998 through 2003 to supplement McKinley deliveries because of operational problems and a major labor shutdown at McKinley. APS/PacifiCorp Reb. Arg. at 23, *Nordlander V.S.* at 4, 9. APS/PacifiCorp also purchased non-McKinley tons during this period as part of coal conservation efforts during the operational problems, as well as to mitigate the impacts of the potential shutdown at McKinley in 2008. *Id.* at 5. The non-McKinley coal has also been purchased, in part, because of the need to test alternative coals in anticipation of that eventual shutdown. *Id.* Finally, APS/PacifiCorp have demonstrated that demand has exceeded the expectations underlying the traffic forecasts that were the basis of the Board's SAC calculations in its *1997* and *1998 Decisions*. APS/PacifiCorp. Reb. Arg. at 23-24, *citing* *Nordlander V.S.* at 9, *Crowley V.S.* at Exhibit TDC-2 and electronic workpaper file "copy of SRB 1995-2000data.xls."

Each of these circumstances justifies the inclusion of non-McKinley tonnage prior to the total shutdown of the mine, and is consistent with the Board's recognition that the parties could introduce evidence of replacement coals to account for "decline[s] in traffic," updated forecasts, and increased demand. BNSF does not dispute that the above-referenced non-McKinley "replacement" coals were indeed purchased and received at the Cholla and Coronado Stations. Instead, BNSF attempts to exclude these historical non-McKinley tonnages because they are not the product of a McKinley

“shutdown.” As APS/PacifiCorp have demonstrated, the Board did not intend such a narrow scope of reopening.

IV. BNSF’S EXCLUSION OF TONNAGE FOR FUTURE TIME PERIODS IS UNFOUNDED

BNSF’s attempt to exclude certain non-McKinley tons for future time periods is equally unfounded. BNSF offers two grounds for these limitations:

APS/PacifiCorp’s projected burn for 2008 through 2013 at Cholla is overstated because it assumes the Cholla plant will operate at { } (BNSF Reply at 17-19); and the inclusion of “supplemental coal” in the Coronado traffic for 2007 through 2013 is inconsistent with Salt River’s internal forecasts (*id.* at 14-15). Neither one of these criticisms, however, is supported by the record. *See* APS/PacifiCorp Reb. Arg. at 26-28. Rather, APS/PacifiCorp have demonstrated that BNSF’s capacity factor calculations are in error due to incorrect heat rate assumptions. *Id.* at 26. Even if BNSF’s calculations were correct, the Cholla units have experienced annual average capacity factors above { }, including years in which they have exceeded { }. *Id.* at 27, *citing* Nordlander R.V.S. at 7; Durning V.S. at 2-3. APS/PacifiCorp also have demonstrated, contrary to BNSF’s suggestion, that the Board has never capped capacity factor levels absent evidentiary proof that such a cap was appropriate. *Id.* at 27-28. Likewise, BNSF’s critique of the Coronado projections is unsupported by the record and badly mischaracterizes the verified, reasonable business expectations that were set forth in Salt River’s forecasts made in the ordinary course of business and produced in this proceeding pursuant to an STB subpoena. *Id.* at 28-31.

**V. APS/PACIFICORP'S INFLATION FORECASTS
ARE THE BEST EVIDENCE OF RECORD**

The parties also disagree as to the proper methodology for updating inflation forecasts used in their respective DCF models. APS/PacifiCorp used the 13-year historical trend line to project inflation in connection with the calculation of revenues for movements in the 2004 through 2013 time period. APS/PacifiCorp Reb. Arg. at 35-38. BNSF objects to this approach, and suggests alternatively that the Board should use a six-year historical average to calculate changes in updated indices, including inflation indices. *See* BNSF Reply at 24.

As demonstrated on Rebuttal, the APS/PacifiCorp approach is preferable, and is consistent with the Board's approach in other rate cases. *See* APS/PacifiCorp Reb. Arg. at 36-37, *citing* Docket No. 37809, *McCarty Farms v. Burlington N. Inc.*, (STB served Aug. 14, 1997) at 54-55 n.128; *see also Nevada Power II*, 10 I.C.C.2d at 271. Furthermore, the long-term trend line approach is consistent with earlier rulings in this proceeding. For example, in updating its DCF analysis in the 1998 Decision, the Board did exactly what Mr. Crowley and APS/PacifiCorp have done on reopening – it added newly available data and developed a trend using all historical data. *See* APS/PacifiCorp Reb. Arg. at 37.

Alternatively, pursuant to the Board's July 2, 2004 request, APS/PacifiCorp recently submitted supplemental calculations showing the impacts of applying the inflation forecasts prepared by Global Insight that have been applied by the Board in recent rate cases. *See* Letter dated July 20, 2004 from Frank J. Pergolizzi to David M. Konschnik, Attachment No 2 at 2. In the event that the Board does not accept

APS/PacifiCorp's inflation assumptions, the use of the Global Insight forecasts, as applied by APS/PacifiCorp, is preferable to the inherently flawed approach taken by BNSF in its Reply evidence.

CONCLUSION

For all of the foregoing reasons, and the reasons set forth in APS/PacifiCorp's Opening and Rebuttal Evidence and Argument on Reopening, the rate levels developed by APS/PacifiCorp are properly calculated under the Board's SAC guidelines and its *2003 Decisions*. Accordingly, APS/PacifiCorp respectfully request that the Board prescribe maximum reasonable rates for the issue movements from and after May 22, 2003 at the levels set forth at page 39 of their Rebuttal Argument. APS/PacifiCorp also request that the Board rule that the minimum volume requirement contained in BNSF Pricing Authority 90069 is unlawful, award reparations to APS/PacifiCorp for amounts paid in excess of maximum reasonable levels since May 22,

2003, plus appropriate interest, and grant any other suitable relief as determined by the Board.

Respectfully submitted,

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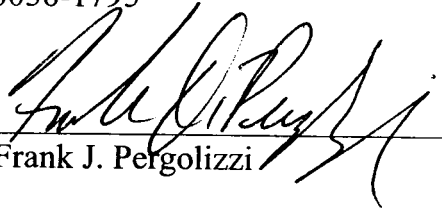
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CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of August, 2004, I served a copy of the foregoing Brief on Reopening by hand upon counsel for Defendant, as follows:

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