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September 21, 2004



By Hand Delivery

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

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

Dear Secretary Williams:

Pursuant to the Board's decision served on September 9, 2004 in the captioned proceeding, The Burlington Northern and Santa Fe Railway Company submits an original and 10 copies of its summary of oral argument discussion points that it proposes to address during the oral argument in this matter that the Board has scheduled for September 29, 2004.

Oral argument on behalf of BNSF will be divided between Mr. Richard E. Weicher, Vice President and Senior Regulatory Counsel for the company, and the undersigned.

Sincerely,

Samuel M. Sipe Jr.

Samuel M. Sipe, Jr.

cc: C. Michael Loftus, Esq., w/enclosure

**BNSF'S SUMMARY OF ORAL ARGUMENT DISCUSSION POINTS
IN DOCKET 41185**

1. This case involves a limited reopening of the Board's rate prescription for the movement of coal from the McKinley Mine, near Gallup, New Mexico to the Cholla plant owned by APS and PacifiCorp (hereafter jointly referred to as "APS"). In the original proceeding, the volume projections for the McKinley Mine, the only coal source for the stand-alone railroad ("SARR"), were hotly contested by the parties. Santa Fe, BNSF's predecessor, disputed APS' coal volume assumptions, arguing that the mineable reserves at the McKinley Mine would run out well before the end of the SAC analysis period. In its 1998 decision, the Board accepted APS' volume assumptions and prescribed a rate of \$3.54 per ton effective First Quarter 1994. The Board's prescribed rate was well below the \$6.31 challenged rate. As it turned out, BNSF was correct about the mineable reserves at the McKinley Mine. BNSF sought a reopening this proceeding and demonstrated that the McKinley Mine volume projections assumed by the Board in the original proceeding were substantially overstated.

2. On reopening, both parties submitted revised DCF analyses to account for the changed circumstances relating to the reserves at the McKinley Mine. Both parties submitted evidence showing that the cumulative amount by which stand-alone revenues exceed stand-alone costs on a present value basis is significantly lower than that calculated by the Board in the original rate prescription. The Board calculated a \$69.6 million overage in the 1998 decision, whereas in this reopening APS calculated a \$42.9 million overage and BNSF calculated only a \$27.3 million overage. As a general matter, under SAC methodology, the smaller the revenue overage, the smaller the rate reduction. While the overage is less under both parties' calculations, APS nevertheless assumes that the prescribed rate should go *down* in 2003. Such a result cannot be squared with the changed circumstances that have caused the Board to reopen its

rate prescription in this proceeding -- the SARR will receive substantially less revenue than projected due to the anticipated closure of the McKinley Mine while costs have not changed significantly.

3. APS reaches its implausible result by ignoring the fundamental SAC principle, discussed in the Board's 1997 decision, that SAC costs must equal SAC revenues over the 20-year DCF period. As the Board explained: "Netting is essential, however, because without it the railroad would have no means to recover the revenue shortfalls that would be incurred in certain periods. The netting procedure balances out overpayments and shortfalls so that the sum of the present value of all overpayments and shortfalls for the 20-year DCF period equals zero." *APS v. ATSF*, 2 S.T.B. 367, 393. Under APS' approach, the SARR never generates sufficient revenue to cover its full costs. See BNSF Reply, Baranowski Verified Statement, Table MRB-4.

4. This impermissible shortfall results from APS' failure to acknowledge that the maximum rates it calculates for the SARR during the elapsed portion of the DCF period are higher than those that the Board prescribed in its 1998 Decision. The SARR cannot logically be credited with revenues higher than those actually received. In contrast to APS' approach, BNSF's DCF analysis takes into consideration the actual revenues that BNSF has received on the challenged movement in the elapsed portion of the DCF period and it includes a capital allocation adjustment to ensure that stand-alone revenues equal stand-alone costs over the 20-year DCF period. BNSF's capital allocation adjustment thus ensures full cost recovery over the 20-year DCF period, consistent with the basic premise of SAC methodology.

5. Contrary to APS' claims, BNSF's approach does not constitute unlawful retroactive ratemaking. The Board vacated the prescriptive effect of its prior rate determination as of May 22, 2003. Under BNSF's DCF analysis, the rates previously prescribed by the Board

would remain unchanged through May 21, 2003 and will not be reduced retroactively. BNSF only seeks a change in the previously prescribed rates from May 22, 2003 forward. Indeed, BNSF's calculations accept the Board's prescribed rates for the elapsed period of the DCF and merely establishes rates that would be adequate in future years to cover the full costs of the SARR in light of changed circumstances.

6. The difference in capital allocation assumptions is the most significant difference between the parties, but the parties also disagree on other factual and methodological assumptions related to the calculation of revenues and costs, as identified in Exhibit TDC-6, including the calculation of future inflation, the calculation of cross-over revenue divisions, and the exclusion of non-McKinley tons prior to 2007. BNSF submitted a revised Exhibit TDC-6 so that the Board could see the full range of outcomes under the parties' different approaches to capital allocation and the parties' different factual and methodological assumptions. As seen in that Exhibit, under APS' approach to capital allocation, the prescribed rates for 2003 range from \$4.10 to \$4.30 depending on the treatment of factual and methodological issues in dispute. Under BNSF's capital allocation approach, the prescribed rates for 2003 range from \$5.40 to \$7.15.

7. Finally, BNSF requests that the Board decide this issue as quickly as possible. While this reopening is pending, the Board has stated that BNSF may only charge APS \$4.21 per ton for coal moving from the McKinley Mine to Cholla plant. This rate is lower than the Board's previously prescribed rate of \$4.30 for 2004 and \$4.75 for 2005. Consequently, since the beginning of 2004, BNSF has not been receiving as much revenue for the movement as it would have received if the previously prescribed rate had remained in effect.