

STEPTOE & JOHNSON LLP

ATTORNEYS AT LAW

Samuel M. Sipe, Jr.
202.429.8486
ssipe@steptoe.com

1330 Connecticut Avenue, NW
Washington, DC 20036-1795
Tel 202.429.3000
Fax 202.429.3902
steptoe.com

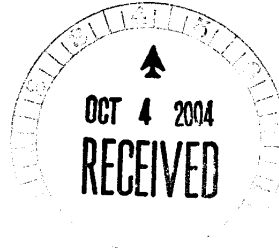
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October 4, 2004

Via HAND DELIVERY

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

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

Dear Secretary Williams:

At the September 29, 2004 oral argument in this matter, two questions arose that were not addressed in the parties' briefs or evidence. First, Vice-Chairman Mulvey inquired regarding the current level of variable costs and the current R/VC ratio for the issue traffic movement. Second, Chairman Nober inquired whether the Board has the statutory authority to prescribe rates for the remaining years of the 20-year DCF period if the Board determines that the maximum reasonable rates for that period exceed the challenged rate. Chairman Nober asked the parties to consider 49 U.S.C. §§ 10701 and 10704 in addressing this question. BNSF has had an opportunity to look into these questions further and responds below.

Variable Costs

Variable costs are not at issue in this reopening proceeding. Therefore, the record on reopening does not contain any evidence on the current level of variable costs for the issue traffic movement and BNSF has not recalculated the present level of variable costs on the bases set out in the Board's 1997 decision. Neither party believed it was necessary to carry out a variable cost analysis for purposes of determining what changes must be made to the future prescribed rates. As BNSF explained at the September 29 argument, both parties assume that the SAC overage (revenues in excess of costs) is significantly smaller than it was when the SAC analysis was originally carried out. The smaller overage indicates that the rate prescription should increase to ensure that SAC revenues equal SAC costs over the 20-year rate prescription period. The only issue here is the extent of the increase that is warranted in light of the changed circumstances.

Statutory Limits On Rate Prescription Authority

BNSF has had an opportunity to review more thoroughly Sections 10701 and 10704 and it would like to supplement counsel's comments made at the oral argument on the issue raised by Chairman Nober. BNSF's position, explained at the September 29 argument, is that the Board is

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required to prescribe rates that permit a full recovery of SAC costs over the 20-year rate prescription period. The statutory provisions identified by Chairman Nober provide ample authority to implement this requirement if the Board determines that rates exceeding the challenged rates must be charged during some portion of the 20-year period to ensure full cost recovery.

Section 10701(d)(1) sets forth the general rule establishing the Board's jurisdiction over a rail carrier's rates. That provision states that a rate "established" by a rail carrier with market dominance over the transportation to which the rate applies must be "reasonable." In this case, BNSF's predecessor, The Atchison, Topeka and Santa Fe Railway Company ("Santa Fe"), "established" the rate of \$6.31 per ton as of January 1, 1994 for the issue traffic. The Board found that Santa Fe had market dominance over the transportation at issue and that the rate established by Santa Fe exceeded a "reasonable" rate.

Section 10704(a)(1) specifically addresses the Board's rate prescription authority. It states that the Board may prescribe "the maximum rate . . . to be followed" if it finds that "a rate charged or collected" by a market dominant rail carrier "does or will violate this part." The only limit on the Board's rate prescription authority in Section 10704 is that the Board must find, after a full hearing, that a rate "charged or collected" violates the reasonableness requirement of Section 10701. The statute focuses on rates that were or are being "charged or collected." In this case, the only rates "charged or collected" by BNSF were the rates in place during the pendency of the litigation and the Board found that those rates violated the reasonableness requirement of Section 10701.

Once the Board finds that a rate "charged or collected" is unreasonable, then the carrier's rate making prerogative is suspended for the future and Section 10704 states that the Board may "prescribe a maximum rate to be followed." Section 10704 does not contain any limits on the level of the prescribed rate that the Board may establish once the Board makes a finding that the rate "charged or collected" exceeds a reasonable rate. Neither Section 10704 nor any other statutory provision requires that the prescribed rate in every year of a 20-year rate prescription must be at a level below the rate "charged or collected" by the carrier.

In fact, the Board regularly prescribes rates that increase over the rate prescription period to levels that exceed the rates "charged or collected" during the pendency of the litigation. For example, in the recent *TMPA v. BNSF* case, Docket No. 42056, the challenged rate was \$19.09 as of the Second Quarter 2001, the beginning of the period covered by the complaint. The Board found that this rate was unreasonable under the Board's DCF analysis, which encompassed the period Second Quarter 2001 through First Quarter 2021. The Board suspended the rate, ordered reparations for payments made during the period that the rate was "charged or collected" by BNSF, and prescribed new rates for the future. The prescribed rate, as modified in the Board's recent decision on reconsideration, begins at \$18.61, below the level of the rates "charged or collected" while the case was pending before the Board, but it increases to \$24.34 by 2010, a level well above the rates "charged or collected."

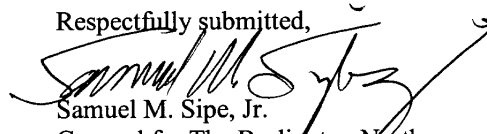
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A common carrier rate authority may have an escalation provision that allows the Board to determine what the carrier would likely charge in the future if the carrier's ratemaking authority were not suspended. The Board uses such escalation provisions in the SAC analysis to project the future revenues that would be available to the SARR from the issue traffic. This is only one of many predictions about the future that the Board must make in a SAC analysis to determine whether the rates "charged or collected" are reasonable. But once the Board determines that the rates "charged or collected" are unreasonable, then Section 10704 gives the Board authority to prescribe for the future the maximum rates to be followed. Nothing in the statute limits the Board to prescribing rates that are lower than those projected in the SAC analysis.

Under the SAC test, when the Board prescribes rates "to be followed" in the future, it establishes the future rates at a level that ensures a full recovery of SAC costs. That may require a significant increase in future rates over the level of the rates "charged or collected" while the litigation is pending. Thus, in *Coal Trading Corp. v. B&O Railroad*, 6 I.C.C.2d 361 (1990), the ICC used a 20-year DCF analysis to determine that rates charged by Norfolk Southern for export coal movements during the period 1979-1986 were unreasonable and to establish the reparations due to complainants for shipments during that historical period. In prescribing rates for the remaining years of the 20-year DCF period, the ICC set future rates at a level that ensured a full recovery of the SAC revenue requirement in each of the remaining years of the DCF analysis. The result was a rate prescription that called for rate *increases* in each future year of the DCF period. The rate prescribed for 1998, the final year of the DCF period, represented a 97 percent increase in 1998 over the 1986 rate.

In short, both the language of Section 10704 and the Board's prior practice in prescribing rates lead to the conclusion that there is no statutory limit on the ability of the Board to prescribe a rate for future years of the 20-year rate prescription period in this case at a level that ensures the full recovery of SAC costs over the 20-year period. Indeed, such a result is required by SAC principles.

Respectfully submitted,



Samuel M. Sipe, Jr.
Counsel for The Burlington Northern
And Santa Fe Railway Company

cc: Chairman Nober
Vice-Chairman Mulvey
Commissioner Buttrey
C. Michael Loftus