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PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD



WESTERN FUELS ASSOCIATION, INC.
and BASIN ELECTRIC POWER
COOPERATIVE, INC.

Complainants,

v.

BNSF RAILWAY COMPANY

Defendant.

Docket No. 42088

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REPLY EVIDENCE OF COMPLAINANTS
WESTERN FUELS ASSOCIATION, INC. AND
BASIN ELECTRIC POWER COOPERATIVE, INC.

NARRATIVE AND EXHIBITS
VOLUME 1 OF 1

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And BASIN ELECTRIC POWER
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ACRONYMS

The following acronyms are used:

Basin/Basin Electric	Basin Electric Power Cooperative, Inc.
BNSF	BNSF Railway Company, f/k/a The Burlington Northern and Santa Fe Railway Company
DCF	discounted cash flow
EOTD	end-of-train device
GTM	gross ton-miles
ICC	Interstate Commerce Commission
LRS	Laramie River Generating Station
LUM	locomotive unit-mile
O/D	origin/destination
PRB	Powder River Basin of Wyoming
QRS	Quality Rail Services, LLC
R/VC	revenue-to-variable cost
SEM	switch engine minutes
STB	Surface Transportation Board
T&E	train and engine crew
T&O	traffic and operating
UP	Union Pacific Railroad Company
URCS	Uniform Railroad Costing System
VC	variable cost
WFA	Western Fuels Association, Inc.

CASE GLOSSARY

The following short form case citations are used:

<u>TMPA I</u>	<u>Texas Municipal Power Agency v. Burlington Northern and Santa Fe Ry., STB Docket No. 42056 (STB served March 24, 2003)</u>
<u>TMPA II</u>	<u>Texas Municipal Power Agency v. Burlington Northern and Santa Fe Ry., STB Docket No. 42056 (STB served Sept. 27, 2004)</u>
<u>WTU</u>	<u>West Texas Utilities Co. v. Burlington Northern R.R., 1 S.T.B. 638 (1996), aff'd sub nom. Burlington Northern R.R. v. S.T.B. 114 F.3d 206 (D.C. Cir. 1997)</u>
<u>WPL I</u>	<u>Wisconsin Power & Light Co. v. Union Pacific R.R., STB Docket No. 42051 (STB served Sept. 13, 2001)</u>
<u>Xcel I</u>	<u>Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry., STB Docket No. 42057 (STB served June 8, 2004)</u>
<u>Xcel II</u>	<u>Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry., STB Docket No. 42057 (STB served Jan. 19, 2005)</u>

**I - Counsel's Reply Argument
and Summary of Evidence**

**WESTERN FUELS ASSOCIATION, INC.
and BASIN ELECTRIC POWER
COOPERATIVE, INC.**

v.

Defendant.

I. COUNSEL’S REPLY ARGUMENT AND SUMMARY OF EVIDENCE

BNSF's¹ opening variable cost evidence -- though overstated for the reasons discussed below -- confirms that BNSF's tariff rates are outrageously high. These outrageously high rates are not "commercially" justified, as BNSF witness Kalt speculates.² Instead, BNSF's pricing actions reflect an obvious effort to exploit the Board's maximum rate processes.

A. BNSF'S VARIABLE COST CALCULATIONS ARE OVERSTATED

In their opening evidence, both WFA/Basin³ and BNSF calculated variable costs for all BNSF movements from the Powder River Basin (“PRB”) to the Laramie

¹ Defendant BNSF Railway Company (“BNSF”).

² See Opening Evidence of BNSF Railway Company (“BNSF Opening Evidence”) at II-21 to II-31.

³ Complainant Western Fuels Association, Inc. (“WFA”) and Basin Electric Power Cooperative, Inc. (“Basin” or “Basin Electric”), collectively “WFA/Basin.”

River Station (“LRS”) in the fourth quarter of 2004 (“4Q04”). For example, for one representative movement (Dry Fork to LRS) WFA/Basin calculate 4Q04 variable costs at \$1.42 per ton in 4Q04.⁴ BNSF’s calculations for this movement equal \$2.01 per ton.⁵ BNSF’s costs are higher than WFA/Basin’s because BNSF has overstated several key variable cost components.⁶

- Yard Switching. BNSF includes { } per ton for yard switching on the LRS movement.⁷ BNSF’s calculation is a remarkable one because, as BNSF concedes, the LRS trains do not go through any BNSF yards, and BNSF performs no yard switching on LRS trains.⁸ WFA/Basin properly exclude “yard switching” costs in their variable cost computations.⁹

- Locomotive Fuel. BNSF calculates fuel costs based upon the results of a special study.¹⁰ In some past cases, the STB has accepted fuel special study results where the study methodology was proper and the underlying study data and study

⁴ WFA/Basin Op. Narr. at II-A-30.

⁵ BNSF Op. Narr. at II-19.

⁶ In their reply evidence, WFA/Basin restate opening variable costs to include, inter alia, new traffic and operating (“T&O”) factors the parties agreed upon as a result of the technical conference in this case. WFA/Basin’s reply variable cost results are summarized below at page II-A-18.

⁷ BNSF Op. Exhibit II-A-1.

⁸ BNSF Op. Narr. at II-1 to II-2.

⁹ WFA/Basin Reply Narr. at II-A-3 to II-A-5.

¹⁰ BNSF Op. Narr. at II-12.

computer programs were provided to the other party and the Board.¹¹ BNSF's special study does not meet these standards. BNSF's study methodology is fatally flawed in numerous respects. For example, the vast majority of locomotives on LRS trains are SD70 MACs. BNSF, however, did not collect any study data from these locomotives.¹²

Moreover, BNSF did not provide the underlying study data that it did collect, or the programs used to manipulate that data, to either WFA/Basin or the Board.¹³ Accordingly, it is impossible for WFA/Basin, or the Board, to know if BNSF properly evaluated the data it did collect. WFA/Basin's system-average fuel costs remain the best evidence of record. See Wisconsin Power and Light Co. v. Union Pacific R.R., STB Docket No. 42051 (STB served Sept. 13, 2001) ("WPL I") at 55 (when faced with a choice between system-average fuel cost and flawed special study fuel costs, the STB utilizes system-average fuel costs).¹⁴

- Locomotive Capital. BNSF inflates its locomotive capital costs, inter alia, by including a "spare margin" factor that includes locomotive idle time.¹⁵ As

¹¹ See Texas Municipal Power Agency v. Burlington Northern and Santa Fe Ry., STB Docket No. 42056 (STB served March 24, 2003) ("TMPA I") at 58, on reconsideration (STB served Sept. 27, 2004) ("TMPA II") at 12-13; Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry., STB Docket No. 42057 (STB served June 7, 2004) ("Xcel I") at 137, on reconsideration (STB served Jan. 19, 2005) ("Xcel II").

¹² WFA/Basin Reply Narr. at II-A-12 to II-A-13.

¹³ Id., WFA/Basin Reply Exhibit II-A-1.

¹⁴ Accord TMPA I at 68 (rejecting BNSF special study results where the underlying computer programs and data were not "made available for [STB] review and manipulation").

¹⁵ BNSF Op. Narr. at II-10 to II-17.

WFA/Basin demonstrated in their opening evidence, inclusion of such “idle time” is contrary to over twenty five years of ICC/STB costing precedent.¹⁶ In addition, the special study BNSF relies upon to calculate its inflated spare margin figure is unsupported¹⁷ and BNSF miscalculates the involved locomotive lease rates.¹⁸

WFA/Basin’s calculation of movement-specific locomotive capital costs employs special study procedures, including the use of non-inflated locomotive spare margin calculations and correctly calculated locomotive lease rates that conform to years of settled STB precedent.¹⁹ These calculations are the best record evidence.

- Other Costs. BNSF mistakenly relies on system-average costs, as opposed to WFA/Basin’s more accurate, properly calculated movement-specific costs, for cost items such as roadway maintenance,²⁰ locomotive maintenance²¹ and road property costs.²² BNSF also overstates several other cost items (e.g., station clerical) because it uses an outdated 2003 base year URCS instead of the more current 2004 URCS that WFA/Basin use.²³

¹⁶ See WFA/Basin Op. Narr. at II-A-25 to II-A-27.

¹⁷ See WFA/Basin Reply Narr. at II-A-15 to II-A-16.

¹⁸ See id.

¹⁹ See WFA/Basin Op. Narr. at II-A-23 to II-A-27.

²⁰ See WFA/Basin Reply Narr. at II-A-11.

²¹ Id. at II-A-13.

²² Id. at II-A-11.

²³ Id. at II-A-9.

**B. BNSF'S COSTS, WHILE OVERSTATED, CONFIRM
THE LRS RATES ARE EXTRAORDINARILY HIGH**

BNSF's own overstated cost evidence confirms that the LRS rates are extraordinarily high. The BNSF revenue-to-variable cost ("R/VC") ratios for the LRS traffic are shown in Reply Table I-1, below.

Reply Table I-1 Computation of R/VC Ratios Using BNSF Variable Costs, PRB to LRS (4Q04)			
<u>Origin</u>	<u>Rate with Surcharge</u>	<u>Variable Cost</u>	<u>R/VC</u>
Dry Fork	\$6.71	2.01	334%
Eagle Butte	6.72	2.05	327
Cordero	6.48	1.76	368
Cabollo Rojo	6.53	1.80	362
Jacobs Ranch	6.25	1.61	388

As shown in Table I-1, the R/VC ratios using BNSF's overstated costs for 4Q04 LRS traffic movement range from 327% to 388%. BNSF's LRS tariff calls for significant rate increases in both 2006 and 2007.²⁴ WFA/Basin projects – using BNSF's costs – that at the end of 2007, the R/VC ratios on LRS traffic will range from 436% to 514%.²⁵

Thus, even BNSF's cost calculations – which are significantly overstated – confirm the obvious: BNSF has published extraordinarily high rates on the LRS traffic.

²⁴ See WFA/Basin Op. Narr. at III-A-12.

²⁵ See WFA/Basin Reply electronic workpaper "2007 R_V C Ratios on LRS Traffic.123."

**C. BNSF'S PRICING ACTIONS ARE
NOT "COMMERCIALLY" JUSTIFIED**

The LRS tariff rates vastly exceed the rates WFA/Basin was paying under the expired LRS transportation contract.²⁶ The decision to impose these high rates was made by BNSF management. However, BNSF management does not appear in BNSF's opening evidence to defend its pricing actions. The non-appearance of BNSF management is not surprising. BNSF management is obviously aware that the current STB maximum rate standards contain a giant loophole – i.e., the higher the starting price, the higher the STB maximum rate answer.²⁷ BNSF management exploited this loophole by publishing extraordinarily high tariff rates for the LRS traffic.²⁸

Instead of appearing and explaining its pricing actions, BNSF management asks Professor Kalt to provide his opinions on why BNSF's tariff actions are "commercial[ly]" reasonable.²⁹ Professor Kalt proceeds to do so. Professor Kalt's various "commercial" justifications for BNSF's pricing actions (e.g., the expiring LRS contract rates were low, BNSF needs to charge higher LRS rates to fund new PRB

²⁶ See WFA/Basin Reply Narr. at IV-4 to IV-7.

²⁷ See WFA/Basin Op. Narr. at III-H-10 to III-H-13.

²⁸ BNSF's behavior during discovery confirms this point. At the outset of this case, WFA/Basin asked BNSF to produce its internal documents it prepared prior to the filing of the LRS tariff that explains the basis for BNSF's pricing actions. BNSF initially claimed all responsive documents were protected from discovery by the attorney client privilege and later produced a few extraneous pages that contained no management-prepared explanation for BNSF's actions. See WFA/Basin Reply Narr. at IV-2 to IV-4.

²⁹ See BNSF Op. Narr. at II-23. BNSF asserts such testimony is necessary to respond to WFA/Basin's claims that BNSF's rates are commercially unreasonable. Id. Of course, the gravamen of WFA/Basin's complaint before the Board is that BNSF's pricing actions are unreasonable under the regulatory reasonableness standards administered by the Board. See WFA/Basin Complaint at ¶¶9, 12 (filed Oct. 19, 2004).

infrastructure, etc.) are wrong.³⁰ More importantly, Professor Kalt's testimony is really a side-bar exercise designed to divert the Board's attention from BNSF's regulatory incentive to publish high tariff rates.³¹

**D. BNSF'S ASSERTED REVENUE NEEDS ALSO
DO NOT JUSTIFY ITS PRICING ACTIONS**

In addition to Professor Kalt's asserted "commercial" justifications for BNSF's draconian rate increases, BNSF counsel argues the mega-increases are justified because BNSF is a "revenue inadequate" carrier. The only way BNSF can achieve revenue adequacy, in BNSF's counsel's opinion, is for BNSF to charge rates on its captive traffic that average "316 percent of its variable costs."³²

BNSF's claims of "revenue inadequacy" must be taken with a grain of salt since BNSF's representations concerning its financial health are audience-specific. In all of its recent reports to its shareholders, BNSF has extolled its financial strength, its record earnings and its overall financial well-being.³³ BNSF's rosy financial reports to its shareholders are aptly encapsulated in its 2003 Form 10K:

³⁰ See WFA/Basin Reply Narr. at IV-7 to IV-9.

³¹ Id. at IV-2 to IV-3.

³² BNSF Op. Narr. at I-6.

³³ See, e.g., BNSF 1st Quarter 2005 Investors' Report (April 28, 2005) at 1 (BNSF reports "[r]ecord first-quarter earnings"); BNSF Annual 2004 Investors' Report (Jan. 25, 2005) at 1 (BNSF reports "all-time record quarterly earnings"), BNSF 3rd Quarter 2004 Investors' Report (Oct. 26, 2004) at 1 (BNSF "reports record all-time quarterly revenue"); BNSF 2nd Quarter 2004 Investors' Report (July 27, 2004) at 1 (BNSF records "record" second quarter earnings and freight revenue); BNSF 1st Quarter 2004 Investors' Report (Apr. 27, 2004) at 1 (BNSF reports "record revenue growth in the first quarter"); BNSF Annual 2003 Investors' Report (Jan. 27, 2004) at 1, 2 (BNSF "reported record fourth quarter 2003 earnings" and "record freight revenues" in 2003). Copies of the referenced reports are included in WFA/Basin Reply electronic workpaper "BNSF.Invest Rep.pdf."

For 2004 and the foreseeable future, the Company expects that cash from operating activities, access to capital markets and bank revolving credit agreements will be sufficient to enable the Company to meet its obligations when due. The Company believes these sources of funds will also be sufficient to fund capital additions that are necessary to maintain its competitiveness and position the Company for future revenue growth.

BNSF Form 10K Annual Report Pursuant To Section 13 or 15(d) of the Security Exchange Act of 1934 for the Fiscal Year Ended Dec. 31, 2003 (filed Feb. 2, 2004) at 17 (excerpts included in WFA/Basin electronic workpaper "BNSF 10K_001.pdf").

BNSF tries to paint a different financial picture in maximum rate case proceedings before the Board. In the instant case, and in other maximum rate cases, BNSF proclaims that it is "revenue inadequate" under the STB's revenue adequacy standards. BNSF goes on to assert, as it does here, that it needs more revenue to extricate itself from the financial abyss of "revenue inadequacy."³⁴

Obviously, BNSF cannot be both financially healthy (as it tells its shareholders) and teetering on financial ruin (as it tells the STB). The problem lies in the STB's rules for measuring revenue adequacy. Individual STB members have acknowledged that the STB's revenue adequacy rules can produce flawed results (i.e., ones that substantially overstate railroad's actual financial needs),³⁵ but, to date, the STB has not acted to fix the problem.

³⁴ See BNSF Op. Narr. at I-3 to I-6.

³⁵ See, e.g., Railroad Revenue Adequacy-1995 Determination, 1 S.T.B. 167, 168-171 (1996) (the three sitting STB Board members note, with concern, that Board revenue adequacy rules may overstate carriers' actual revenue needs).

In any event, both the STB, and its predecessor the ICC, have consistently held that BNSF's "revenue inadequate" status does not grant BNSF a license to charge whatever it wants on captive traffic. See, e.g., Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 536 (1985) ("a rate may be unreasonable even if the carrier is far short of revenue adequacy"); Xcel II at 6 (same). Nor do STB precedents suggest that captive traffic should pay on average 316% of variable costs.

This 316% figure equals the Board's five-year average "RSAM" – i.e., the average amount [BNSF] would need to charge all its potentially captive traffic (traffic priced above 180% of variable costs)" in order to achieve revenue adequacy under the STB's revenue adequacy rules.³⁶ The Board has never used its RSAM calculations to set maximum rates – and with good reason. Congress intended that the railroads increase revenues by eliminating unprofitable traffic, and by maximizing returns on competitive traffic, not by exploiting captive traffic.³⁷

BNSF's 2004 system figures illustrate this point. In 2004, BNSF's system-average R/VC ratio equaled 131%.³⁸ In order to be considered revenue adequate in 2004

³⁶ See Rate Guidelines – Non Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served May 21, 2004) at 1.

³⁷ See, e.g., Omaha Pub. Power Dist. – Petition Under 49 U.S.C. §10901(d) (STB served Aug. 1, 1996) at 4 ("Congress concluded that the best way [for railroads] to obtain revenue adequacy [was] by means of the interaction of competitive forces") (internal quotation marks omitted); American Shortline R.R. Ass'n v. United States, 751 F.2d 107, 113 (2d Cir. 1984) (same). Arkansas Power & Light Co., – Petition to Institute Rulemaking Proceeding, 365 I.C.C. 983, 988 (1982) (Congress did not intend for captive coal shippers to bear "a disproportionate share of responsibility for the needed improvement in the railroads financial position"); Coal Exporters Ass'n of the United States, Inc. v. United States, 745 F.2d 76, 97-98 (D.C. Cir. 1984) (same).

³⁸ See WFA/Basin Reply electronic workpaper "BNSF 2004 R/VC Ratio_001.pdf."

under the Board's revenue adequacy rules, BNSF needed to obtain a system-average R/VC ratio of 144%.³⁹ Congress clearly did not intend that BNSF make up this 13 percentage point gap by charging captive traffic rates at the absurdly high levels suggested by BNSF.⁴⁰

E. CONCLUSION

BNSF has imposed draconian increases on the LRS traffic. BNSF's overstated cost evidence confirms that the resulting rates are extraordinarily high, and contrary to Professor Kalt's musings, BNSF's actions are not "commercially" justified. WFA/Basin respectfully request the Board to grant the rate relief they requested in their opening submission.

Respectfully submitted,

WESTERN FUELS ASSOCIATION, INC.
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³⁹ Id.

⁴⁰ For example, BNSF's cited RSAM average drops to a R/VC ratio of 235% simply by eliminating BNSF traffic that moves at less than its variable service costs. See Rate Guidelines – Non-Coal Proceedings, supra at 3 (Table 1) (RSAM with "efficiency adjustment" calculation).

**II - A Quantitative
Market Dominance**

II. A. QUANTITATIVE EVIDENCE

1. Variable Costs

In their opening evidence, both WFA/Basin and BNSF develop variable costs for all BNSF movements from the PRB to LRS in the fourth quarter of 2004 ("4Q04"). These movements comprise five separate origin/destination ("O/D") pairs: Dry Fork to LRS; Eagle Butte to LRS; Cordero to LRS; Caballo Rojo to LRS and Jacobs Ranch to LRS.

Reply Table II-A-1 compares the parties' opening 4Q04 variable cost calculations:

Reply Table II-A-1 Comparison of WFA/Basin and BNSF Opening Evidence Variable Cost Calculations For BNSF Movements to LRS (4Q04)			
<u>Origin</u> (1)	BNSF Variable Cost <u>\$/ton</u> (2)	WFA/Basin Variable Cost <u>\$/ton</u> (3)	Difference (Col. 3-Col. 2) <u>\$/ton</u> (4)
Dry Fork	\$2.01	\$1.41	\$0.60
Eagle Butte	2.05	1.45	0.60
Cordero	1.76	1.26	0.50
Caballo Rojo	1.80	1.27	0.53
Jacobs Ranch	1.61	1.21	0.40

In this Reply, WFA/Basin demonstrate that BNSF's variable cost calculations are substantially overstated. WFA/Basin also restate their opening variable cost evidence, where appropriate. WFA/Basin's restated variable costs are summarized in Reply Table II-A-2:

Reply Table II-A-2 WFA/Basin Reply Variable Cost Calculations For BNSF Movements to LRS (4Q04)	
<u>Origin</u>	Reply Variable Cost <u>Per Ton (\$)</u>
Dry Fork	\$1.42
Eagle Butte	\$1.47
Cordero	\$1.28
Caballo Rojo	\$1.29
Jacobs Ranch	\$1.22

a. General Cost Estimation Procedures

Both BNSF and WFA/Basin develop base year URCS unit costs. However, the parties' base years differ. WFA/Basin's base year is 2004.¹ BNSF's base year is 2003.² Both parties indexed their base year URCS unit costs to 4Q04 wage and price levels.

WFA/Basin's approach is superior to BNSF's because WFA/Basin develop the most recent base year URCS (2004). Consistent with past practice, WFA/Basin expect the Board will utilize its final BNSF 2004 URCS run for costing purposes in this case.³

¹ See WFA/Basin Op. electronic workpaper "BNSF 0490.ZIP."

² See BNSF Op. electronic workpaper "BNSF URCS 2003.ZIP."

³ See WPL I at 39 (STB utilizes most recent final URCS run to develop variable costs for the applicable calendar year quarter).

b. Traffic and Operating Characteristics – Overview

Following the submission of the opening evidence, WFA/Basin and BNSF participated in a Board-supervised technical conference process. As a result of this process, WFA/Basin and BNSF agreed to the values of eighteen individual traffic and operating (“T&O”) statistics for each of the five O/D pairs costed in 4Q04.⁴ WFA/Basin incorporate these agreed upon T&O statistics into their reply variable cost calculations.

The parties were unable to reach agreement on the value of two T&O movement statistics: switching engine minutes (“SEM”) per car for switching by yard locomotives and SEM’s per car for switching by road locomotives on non-yard track. Each item is discussed below

c. Traffic and Operating Statistics – Detail

i. Switching – Yard Locomotives (SEM’s/Car)

BNSF’s opening evidence includes { } minutes per car for switching by yard locomotives.⁵ The { } minute calculation is not the product of any special study of yard switching on LRS trains. Instead, it reflects BNSF’s estimate of a system-average switching minute computation for this service.⁶

⁴ See Parties’ letter to the STB (dated May 13, 2005) copy in WFA/Basin Reply electronic workpaper “May 13 ltr. _001.pdf.”

⁵ See BNSF Op. electronic workpaper “BNSF MOBA OPEN PRG.123” Tab Opr _ stats, Line 63.

⁶ See BNSF Op. electronic workpaper “BNSF-03-SWITCH SPLIT.123” Tab B, Line 43, Col. L.

BNSF proceeds to apply these switch minutes to calculate a system-average yard switching cost of { } per car.⁷ This switching cost constitutes a significant percentage of BNSF's total variable cost calculations for the LRS movement. For example, yard switching approximates { } of BNSF's total variable costs for the Dry Fork movement.⁸

BNSF's yard switching calculations are remarkable because, as even BNSF concedes, BNSF's LRS trains do not run through any BNSF yards,⁹ nor is there any recorded instance where BNSF ever used a yard locomotive to switch a car to or from an LRS train. Since no yard switching occurs on the LRS movements, WFA/Basin included no yard switch locomotive minutes, and no yard switching costs, in their opening variable cost calculations.

At the Board's May 17, 2005 technical conference, BNSF counsel acknowledged that BNSF yard locomotives do not switch cars to or from LRS trains. BNSF counsel stated that BNSF's yard switch minute calculations were intended to capture costs BNSF incurs when BNSF switches locomotive unit(s) into, or out of, the LRS trains at non-yard locations. Following the technical conference, WFA/Basin determined that in the most recent quarter for which BNSF provided responsive

⁷ See BNSF Op. electronic workpaper "BNSF MOBA OPEN PRG.123." Tab D, Line 3.

⁸ See BNSF Op. electronic workpaper "BNSF MOBA OPEN PRG.123" Tab D, Column E, Lines 3 and 19.

⁹ See BNSF Op. Narr. at II-2 ("[a]nother distinguishing feature of the Laramie River move is that the Laramie River trains do not pass through a major BNSF yard").

information in discovery (3Q04),¹⁰ BNSF made non-yard power changes on LRS trains, on average, once per every { } one-way (loaded or empty) train round trips.¹¹

In order to minimize switching disputes, WFA/Basin includes in its reply T&O road switching statistics 55 minutes of road switching time for each time a road locomotive is switched into or out of the LRS trains at non-yard locations.¹²

**ii. Switching Road Locomotives
Non-Yard (SEMS/Car)**

BNSF included { } minutes per car for switching by road locomotives at non-yard locations.¹³ At the May 17, 2005 technical conference, BNSF counsel stated these minutes were intended to reflect the time it takes to switch out bad order cars at LRS. The { } minute calculation is not the product of any special study of bad order car switching at the LRS plant. Instead, it reflects BNSF's estimate of a system-average switching minute computation for this service.¹⁴

¹⁰ BNSF produced no responsive 4Q04 records.

¹¹ See WFA/Basin Reply electronic workpaper "3Q04 LOCO CHANGE OUT.XLS."

¹² WFA/Basin emphasize that they add this time to provide the Board with an alternative that addresses BNSF's stated concerns. The 55 minute calculation is taken from the Board's Xcel I decision. In Xcel I, the Board ruled that 55 minutes should be allowed for, inter alia, "reconfiguring the locomotive consist to move the distributed power unit to the head of the train for the return trip to the PRB." Id. at 129. In Xcel I, reconfiguration took place every round trip. In the instant proceeding, DP power reconfiguration does not take place, but locomotives are changed out every { } train loaded or empty trips. The 55 minutes per switching occurrence equates to { } minutes per train or { } minutes per car.

¹³ See BNSF Op. electronic workpaper "BNSF MOBA OPEN PRG.123," Tab Opr_stats, Line 67.

¹⁴ See BNSF Op. electronic workpaper "BNSF-03-SWITCHSPLIT.123," Tab B, Line 42, Column L.

BNSF's use of a system-average road switch minute calculation is inappropriate for two reasons: First, as WFA/Basin explained in their opening evidence, all car switching at LRS is performed by a BNSF contractor – Quality Rail Service, LLC (“QRS”).¹⁵ Since BNSF is not performing this service, it is improper to utilize a BNSF system-average switch minute calculation – which reflects BNSF's average switching time – for a service which BNSF does not perform. Secondly, more accurate movement-specific cost data exists. BNSF pays QRS bills for the switching services QRS performs for BNSF at LRS. WFA/Basin included BNSF's payments to QRS in its opening variable cost calculations.¹⁶ The payments by BNSF to QRS for unloading/switching operations accurately capture the costs BNSF actually incurs for bad order car switching at LRS.

At the May 17, 2005 technical conference, counsel for BNSF observed that QRS uses BNSF's locomotives to provide switching service at LRS. Counsel opined that the fee QRS charges to BNSF (and BNSF pays) does not include BNSF's locomotive capital costs and BNSF's locomotive fuel costs. Under this theory, BNSF is supplying free power to a contractor – a highly unlikely scenario. However, even if BNSF counsel's speculations are true, WFA/Basin's variable costs include, in addition to the QRS payment, the costs BNSF counsel claims are omitted. WFA/Basin's calculation of BNSF's locomotive capital costs include the costs BNSF incurs while the locomotives are being used by QRS¹⁷ and WFA/Basin's calculation of BNSF's fuel costs includes the cost

¹⁵ WFA/Basin Op. Narr. At II-A-4.

¹⁶ *Id.* at II-A-29.

¹⁷ See WFA/Basin Op. electronic workpaper “VC WFA 2004 Open.123” Tab P, Line 61, for any mine.

of fuel consumed while the BNSF locomotives are being used by QRS.¹⁸

d. Cost Calculations

WFA/Basin present their reply variable cost calculations using an illustrative 4Q04 O/D pair: Dry Fork to LRS. Reply Table II-A-3 shows, by cost item, WFA/Basin's opening variable cost calculations and BNSF's opening variable cost calculations for the Dry Fork to LRS movement.

¹⁸ BNSF counsel also argued at the technical conference that WFA/Basin's fuel cost calculations capture only the fuel cost BNSF incurs when QRS provides line-haul, as opposed to switching, service at LRS, and thus understates BNSF's fuel costs. This is not correct. WFA/Basin's use of a system-average fuel consumption rate most likely overstates BNSF's locomotive fuel costs while QRS is using the BNSF locomotives because QRS moves WFA/Basin trains, and switches cars, at far lower than BNSF system-average train speeds and throttle positions. As a result, the BNSF locomotives consume far less fuel than the system-average amounts contained in WFA/Basin's calculations. See, e.g., TMPA II at 12 (locomotive fuel consumption correlated to locomotive throttle position).

Reply Table II-A-3
Variable Cost Per Ton
Dry Fork to LRS
(4Q04)

Service Category (1)	Opening WFA/Basin Cost (2)	BNSF Opening Cost (3)	WFA/Basin Reply Cost (4)	Difference Col. 3 - Col. 4 (5)
1. Carload O/T Clerical Expense	{ }	{ }	{ }	{ }
2. Carload Handling – Other Expense	{ }	{ }	{ }	{ }
3. Switching Expense – Yard Locomotives (SEM)	{ }	{ }	{ }	{ }
4. Switching Expense – Road Locomotives (Non-Yard)	{ }	{ }	{ }	{ }
5. Switching Expense – Road Locomotives (Yard)	{ }	{ }	{ }	{ }
6. Gross Ton-Mile Expense (GTM)/Joint Facility Payment	{ }	{ }	{ }	{ }
7. Loop Track Expense – Origin & Destination	{ }	{ }	{ }	{ }
8. Train-Mile Expense – Other than Crew	{ }	{ }	{ }	{ }
9. Train-Mile Expense – T&E Crew	{ }	{ }	{ }	{ }
10A. Helper Service Expense – Other than Crew	{ }	{ }	{ }	{ }
10B. Helper Service Expense – T&E Crew	{ }	{ }	{ }	{ }
11. Locomotive Unit-Mile Expense	{ }	{ }	{ }	{ }
12. Locomotive Ownership Costs	{ }	{ }	{ }	{ }
13. User Responsibility – Car Repair Expense	{ }	{ }	{ }	{ }
14. Car Operating Expense – Substitute cars	{ }	{ }	{ }	{ }
15. Car Ownership Expense – Substitute cars	{ }	{ }	{ }	{ }
16. Caboose and EOTD Ownership Expense – included in line 8	{ }	{ }	{ }	{ }
17. Loss and Damage Expense	{ }	{ }	{ }	{ }
18A. Third Party Loading Charges	{ }	{ }	{ }	{ }
18B. Third Party Unloading Charges	{ }	{ }	{ }	{ }
19. Total Variable Cost Per Car	{ }	{ }	{ }	{ }
20. Tons Per Car	{ }	{ }	{ }	{ }
21. Variable Cost Per Ton	{ }	{ }	{ }	{ }
22. RFA – URCS Linking Factor	{ }	{ }	{ }	{ }
23. Linked Variable Cost Per Ton	{ }	{ }	{ }	{ }

i. Carload Originated or Terminated – Clerical Expense

The difference in the parties' clerical costs { } is attributable to their calculation of URCS with the different base years. As discussed above, WFA/Basin correctly used the most recent URCS calculations – 2004.

ii. Carload Handling – Other Expenses

The difference in the parties' other carload handling costs { } is attributable to the use of a different base year URCS, and WFA/Basin's removal of system-average carload handling costs not incurred by BNSF in providing LRS service. WFA/Basin's carload handling costs are more accurate than BNSF's and comport with STB precedent.¹⁹

iii. Switching Expense – Yard Locomotive

BNSF includes a cost of { } for yard switching. As discussed above, BNSF does not use yard locomotives to switch cars on LRS trains. WFA/Basin continue to include { } costs for yard switching since BNSF does not incur these cost in providing LRS service.

iv. Switching Expense – Road Locomotives (Non-Yard)

BNSF includes a cost of { } for non-yard bad order switching by BNSF road locomotives at LRS. As discussed above, BNSF does not perform bad order switching at LRS – a contractor, QRS, performs this service, and is compensated by BNSF for it. WFA/Basin properly include BNSF's payment to QRS in their third party

¹⁹ See WFA/Basin Op. Narr. at II-A-13.

unloading costs (item xviii, below).

On reply, WFA/Basin also include a cost of { } per car for BNSF's road switching of its locomotive consists. See page II-A-8, above.

v. Switching Expense – Road Locomotive (Yard)

BNSF road locomotives perform no switching of LRS cars at BNSF yards.

The parties agree that no costs should be included for this item.

vi. Gross Ton-Mile Expenses

Reply Table II-A-4 below compares the parties' opening evidence calculations of Gross Ton Miles ("GTM") expense (per car) for BNSF's Dry Fork to LRS movements in 4Q04.

Reply Table II-A-4 Comparison of WFA/Basin and BNSF Opening Evidence Variable GTM Expenses Per Car Dry Fork to LRS (4Q04)			
<u>Item</u> (1)	<u>BNSF Cost</u> <u>(\$/car)</u> (2)	<u>WFA/Basin</u> <u>Cost (\$/car)</u> (3)	<u>Difference</u> (Col. 2 - Col. 3) <u>(\$/car)</u> (4)
Maintenance-of-Way/Joint Facility Expenses	{ }	{ }	{ }
Return on Road Property Invest.	{ }	{ }	{ }
Road Property Depreciation	{ }	{ }	{ }
Locomotive Fuel Expense	{ }	{ }	{ }
Locomotive Maintenance Exp.	{ }	{ }	{ }
Other GTM Expense	{ }	{ }	{ }
TOTAL	{ }	{ }	{ }

(a) **Maintenance-of-Way/Joint Facilities.** In its opening evidence, BNSF develops system-average maintenance-of-way costs.²⁰ In their opening evidence, WFA/Basin develop line-specific maintenance-of-way costs for the BNSF trackage used by LRS trains between Caballo Junction and Shawnee Junction, WY and develop BNSF system-average maintenance-of-way costs for the other BNSF track segments traversed by LRS trains.²¹ WFA/Basin's evidence is superior to BNSF's because it uses the most recent URCS base year (2004) and because it properly calculates more accurate line-specific maintenance-of-way costs for the Caballo Junction-Shawnee Junction trackage using actual maintenance-of-way cost data produced by BNSF in discovery.²²

(b) **Return on Investment and Depreciation of Road Property.** In its opening evidence BNSF develops system-average road property costs.²³ WFA/Basin developed more accurate line-specific road property costs utilizing the same procedures the STB has routinely accepted in prior cases.²⁴ BNSF's use of system-average costs substantially overstates the road property costs BNSF incurs in providing LRS service. WFA/Basin's lower, more accurate movement-specific costs are the best

²⁰ See BNSF Op. Narr. at II-12, (l) Gross Ton-Mile Costs.

²¹ See WFA/Basin Op. Narr. at II-A-14 to II-A-17.

²² As WFA/Basin noted in its opening evidence, BNSF records line-specific maintenance-of-way data for the Caballo Junction-to-Shawnee Junction line segment pursuant to its joint facility arrangements with UP. *Id.* at Narr. I-9 to I-10.

²³ See BNSF Op. Narr. at II-12, (l) Gross Ton-Mile Costs.

²⁴ See WFA/Basin Op. Narr. at II-A-17.

record evidence.²⁵

(c) **Locomotive Fuel Expense.** At the outset of this case, WFA/Basin asked BNSF whether BNSF had prepared any movement-specific fuel consumption studies on the LRS trains.²⁶ BNSF responded that it had not.²⁷ However, shortly before the parties' opening evidence was due, BNSF counsel informed WFA/Basin counsel that BNSF counsel had just "learned" that BNSF had prepared a special fuel consumption study on the LRS trains.²⁸

BNSF relies upon its special fuel consumption study to calculate its opening evidence fuel costs. This fuel consumption study is substantially different than the special fuel studies presented in recent STB cases.²⁹ For example, in TMPA I the parties utilized agreed upon protocols for collecting raw data, agreed upon protocols to analyze the data, and agreed upon protocols to test the validity of the data collected. None of these protocols and procedures were employed in this case because BNSF secretly prepared its study and presented the results as a fait accompli.

²⁵ When faced with the choice between the use of system-average road property costs, and properly calculated movement-specific road property costs, the Board has consistently accepted movement-specific road property costs. See, e.g., TMPA I at 56-58; Xcel I at 136-137; West Texas Utilities Co. v. Burlington Northern R.R., 1 S.T.B. 638, 724 (1996), aff'd sub nom. Burlington Northern R.R. v. S.T.B. 114 F.3d 206 (D.C. Cir. 1997) ("WTU").

²⁶ See WFA/Basin's Request For Production ("RFP") 36 (served Oct. 20, 2004), copy in WFA/Basin Reply electronic workpaper "DR36_001.pdf."

²⁷ See BNSF's Responses to WFA/Basin's RFP 36 (served Nov. 19, 2004), copy in WFA/Basin Reply electronic workpaper "DR36_001.pdf."

²⁸ See BNSF counsel letter to WFA/Basin counsel (dated March 14, 2005), copy in WFA/Basin Reply electronic workpaper "March 14 ltr._001.pdf."

²⁹ See TMPA I at 58; Xcel I at 137-38.

As discussed in detail in WFA/Basin Reply Exhibit II-A-1, BNSF's secret fuel study contains numerous methodological errors and is not supported by reliable evidence. Accordingly, WFA/Basin continue to utilize BNSF's system-average fuel costs in their reply variable costs.

(d) **Locomotive Maintenance Expense.** In its opening evidence, BNSF calculated system-average locomotive maintenance expenses. In their opening evidence, WFA/Basin utilized system-average locomotive maintenance expense for some locomotive maintenance items but, when the data existed to do so, WFA/Basin adjusted specified URCS locomotive maintenance accounts to reflect the costs BNSF actually incurs in maintaining the SD70MAC locomotives used in LRS service.³⁰ WFA/Basin utilize the appropriate URCS base year (2004) and WFA/Basin's use of a properly calculated locomotive-specific maintenance adjustment comports with governing precedent.³¹

vii. **Loop Track Expense – Origin and Destination**

In their opening evidence, WFA/Basin developed origin and destination loop track variable costs following costing procedures routinely applied in STB maximum rate cases.³² BNSF's opening cost presentation does not contain loop track expenses corresponding to those WFA/Basin developed. In their reply variable costs, WFA/Basin

³⁰ See WFA/Basin Op. Narr. at II-A-19 to II-A-20.

³¹ See, e.g., San Antonio, Texas v. Burlington Northern R.R., 1 I.C.C.2d 561 (1986) (ICC accepts use of locomotive-specific adjustment to system-average variable locomotive maintenance expense calculation).

³² See, e.g., Xcel I at 139; TMPA I at 59; WPL I at 56.

continue to present loop track expenses in the Board-approved format.

viii. Train-Mile Expense – Other than Crew

WFA/Basin's opening calculation of train-mile other costs is slightly higher than BNSF's opening calculation { } due principally to WFA/Basin's calculation of movement-specific train inspection costs at LRS using the actual amounts BNSF pays QRS for QRS's services.³³ WFA/Basin continue to utilize these more accurate movement-specific calculations, not BNSF's system-average calculations.

ix. Train-Mile Expense – Train and Engine Crew

WFA/Basin's opening calculation of variable crew costs is higher than BNSF's by { }. The difference is principally attributable to the fact that BNSF utilized a system-average crew wage unit cost calculation, whereas WFA/Basin developed more accurate movement-specific unit costs. WFA/Basin's approach is more accurate, conforms to STB precedent, and WFA/Basin continue to rely upon it in restating the costs on reply.³⁴

x. Helper Service Expense – LUM and Crew Expense

WFA/Basin included no helper service costs in their opening evidence because BNSF produced no records showing that BNSF provides any helper service on the LRS trains.³⁵ BNSF also did not separately cost helper service.³⁶

³³ See WFA/Basin Op. Narr. at II-A-21.

³⁴ See id. at II-A-21 to II-A-23.

³⁵ See id. at II-A-23.

³⁶ See BNSF Op. Narr. at II-11. While not separately costing helper service, BNSF states that its cost evidence does include reimbursement for system-average helper costs. Id.

xi. Locomotive Unit-Mile Expense

BNSF's opening evidence cost for locomotive unit-mile expense exceeds WFA/Basin's opening costs by { }. BNSF's costs are overstated because they include BNSF's overstated fuel costs; BNSF's overstated locomotive maintenance costs; and other overstated costs. On reply, WFA/Basin utilize the same procedure as they did in the opening evidence to calculate locomotive unit-mile expenses.

xii. Locomotive Ownership Costs

The parties' opening evidence calculations of variable locomotive ownership costs differ by { }. This difference is principally caused by the parties use of a different locomotive spare margin factor. As explained in the opening evidence, WFA/Basin utilize a { } spare margin factor.³⁷ This factor does not reflect locomotive idle time. In its opening evidence BNSF calculates a locomotive spare margin of { }. This spare margin does include locomotive idle time, and as described in Reply Exhibit II-A-2, is based on a flawed special study. For the reasons set forth in Reply Exhibit II-A-2, and in their opening evidence,³⁸ WFA/Basin respectfully request that the Board adhere to longstanding precedent holding that locomotive idle time is not an appropriate component in calculating locomotive spare margins. See WTU at 690 ("[i]f locomotives are idle, they are ready for service and no spares are needed").

BNSF's locomotive ownership costs are further overstated because BNSF, unlike WFA/Basin, calculated locomotive lease payments using constructed life-of-lease

³⁷ WFA/Basin Op. Narr. at II-A-25 to II-A-26.

³⁸ Id.

average payment rates rather than the lease rates BNSF actually paid during the time period being costed.³⁹ BNSF's approach has been consistently rejected by the Board. See e.g., WPL I at 57-58; PSCo I at 142.

xiii. User Responsibility – Car Repair Expense.

In its opening evidence, BNSF improperly includes a cost of { } per car for shipper-owned car operating expenses. This cost is improper because, as WFA/Basin pointed out in their opening evidence, all freight car repairs to WFA/Basin-owned cars are performed at LRS by QRS and then billed to WFA/Basin.⁴⁰ Therefore, BNSF incurs no repair expense for WFA/Basin-owned rail cars.

xiv. Car Operating Expense (Railroad-Owned Only).

WFA/Basin and BNSF include no expenses for this cost category in their opening evidence. BNSF separately invoices, and WFA/Basin separately pay, a \$40 per round trip fee for each BNSF-supplied car. This separate fee reimburses BNSF for its car operating and ownership expenses.⁴¹

xv. Car Ownership Expense (Railroad-Owned Only)

WFA/Basin and BNSF included { } railroad car ownership expenses in their opening variable cost calculations.

³⁹ See WFA/Basin Reply electronic workpaper “BNSF Lease Documentation.pdf” which BNSF provided to WFA/Basin in response to a workpaper request by WFA/Basin after opening evidence was filed.

⁴⁰ See WFA/Basin Op. Narr. at II-A-27.

⁴¹ Id. at II-A-27 to II-A-28.

xvi. Caboose & EOTD Ownership Expense.

WFA/Basin and BNSF did not separately cost this item in their opening evidence. Both included EOTD ownership costs on a system-average basis.

xvii. Loss and Damage.

In its opening evidence, BNSF includes a system-average loss and damage cost of { }. WFA/Basin included { } loss and damage costs in their opening evidence because from 2002 through 2004, BNSF paid { } loss and damage claims for coal moving in LRS trains.⁴² WFA/Basin's approach reflects BNSF's actual expense { } and WFA/Basin adhere to it in their reply evidence.

xviii. Third Party Loading and Unloading Charges.

Consistent with past STB-approved costing procedures,⁴³ WFA/Basin included the monies BNSF actually paid to third-party loading crews at origin, and QRS at destination.⁴⁴ BNSF included no corresponding cost calculations in its opening evidence. WFA/Basin continue to include these third-party charges in the reply cost calculations.

xix. Indexing

The parties utilize similar procedures to index variable costs but start from different base years. BNSF's use of indexed 2003 base year URCS costs produces cost

⁴² See WFA/Basin Op. Narr. at II-A-28.

⁴³ See, e.g., Xcel I at 145; TMPA I at 64.

⁴⁴ See WFA/Basin Op. Narr. at II-A-28 to II-A-29.

overstatements when compared to WFA/Basin's proper use of indexed 2004 URCS costs.

2. Rates and Resulting R/VC Calculations.

Reply Table II-A-5 below summarizes WFA/Basin's reply evidence regarding variable costs per ton, and the resulting revenue-variable cost ratios, for 4Q04 movements:

Reply Table II-A-5 BNSF Rates, Variable Cost and R/VC on PRB Coal Traffic to LRS 4Q04				
Origin (1)	Var. Cost Exh. II-A-__ (2)	Rate (with surcharge) ¹ (\$) (3)	Var. Cost (\$) (4)	R/VC (%) (5)
Dry Fork	7	\$6.71	\$1.42	473%
Eagle Butte	8	6.72	1.47	457
Cordero	9	6.48	1.28	506
Caballo Rojo	10	6.53	1.29	506
Jacobs Ranch	11	6.25	1.22	512
¹ Including fuel surcharge. See WFA/Basin Reply electronic workpaper "T&O WFA Reply.123," sheet "TO Detail."				

The results of WFA/Basin's reply study of BNSF's variable cost of service for each of the five coal movements referenced above are detailed in Reply Exhibits II-A-7 through II-A-11.

II - B Qualitative Market
Dominance
III - Stand-Alone Cost

II. B. QUALITATIVE MARKET DOMINANCE AND

III. STAND-ALONE COST

BNSF presented no qualitative market dominance evidence and no stand-alone cost evidence in its opening evidence.

IV. OTHER EVIDENCE

In addition to presenting overstated variable cost evidence, BNSF's opening evidence also addresses, and attempts to defend, BNSF's massive rate increases on the LRS traffic. As WFA/Basin demonstrated in their opening evidence, BNSF's initial rate increases more than double the expiring LRS contract rates. These initial increases produce rates that exceed 480% of BNSF's variable service costs, average 38 mills per revenue ton-mile, and increase WFA/Basin's freight payments by over \$50 million annually.¹

And, these initial increases are just the beginning. As WFA/Basin also demonstrated in its opening evidence that at the end of the twenty year discounted cash flow ("DCF") period, the LRS rates will be quadruple the expired contract rates, the R/VC ratios will exceed 840%, and WFA/Basin's overall payment increases during the DCF period will exceed \$1 billion.²

BNSF is forced to concede that these draconian increases are "significant."³ However, according to BNSF witness Professor Kalt, the unprecedented increases are "commercially" reasonable.⁴ Professor Kalt's musings avoid the real issue – BNSF's regulatory incentive for imposing the increases – and, in any event, are wrong.

¹ See WFA/Basin Op. Narr. at I-4 to I-5.

² Id.

³ BNSF Op. Narr at II-21.

⁴ Id. at II-23.

A. BNSF'S REGULATORY AGENDA

Professor Kalt testifies concerning asserted "commercial" justifications for BNSF's massive increases on the LRS traffic. One would think that an expert like Professor Kalt who was retained to discuss BNSF's commercial actions would predicate his testimony, in whole or in part, on discussions with the BNSF management who made the pricing decisions, and the material BNSF management relied upon in making those decisions. However, that is not how Professor Kalt proceeded.

Professor Kalt's statement is not based on his discussions (if any) with BNSF management. Nor does Professor Kalt refer to any internal BNSF-generated pricing records or documents concerning BNSF's pricing actions. Instead, Professor Kalt appears to base his opinions entirely on second-hand materials (e.g., press reports). Without more, Professor Kalt is merely providing his opinions on why he believes BNSF's pricing actions are commercially justified. He is not shedding any light on what commercial factors, if any, BNSF management actually considered before it decided to impose draconian rate increases on a long-time customer.

More significantly, Professor Kalt's statement does not address what regulatory motivations underlay BNSF's pricing actions. BNSF's management (not Professor Kalt) decided to impose massive rate increases on the LRS traffic. BNSF management knows why it chose this course of action. However, BNSF management is not talking. At the outset of this case, WFA/Basin asked BNSF to produce internal BNSF documents explaining why BNSF management decided to impose massive tariff-

rate increases on the LRS traffic.⁵ BNSF responded that all responsive internal BNSF documents were exempt from disclosure under the attorney-client privilege.⁶ Similarly, no BNSF management witness appears in BNSF's opening evidence to explain the rationale behind BNSF's pricing actions.

One reason for the non-appearance of BNSF management is obvious. The current maximum rate system permits railroad managements to dictate the regulatory answers based upon the initial tariff rates they set.⁷ It would be shocking for BNSF management not to consider this fact in setting tariff rates on captive coal traffic, and the clear inference is that BNSF did so here. BNSF does not need its lawyers (or professor Kalt) to assist it in setting coal rates based on commercial factors. However, BNSF would rely on advice from its lawyers, and its outside consultants, where regulatory strategy – not commercial concerns – dictated its tariff pricing actions.

In order to provide the Board with a complete record, WFA/Basin responds below to Professor Kalt's musings concerning "commercial" issues. The point to be emphasized, however, is that Professor Kalt's testimony ignores the real issue here – BNSF's regulatory incentive to post massive rate increases on the LRS traffic.

⁵ See WFA/Basin Request for Production ("RFP") No. 2 (served Oct. 20, 2004), copy at WFA/Basin Reply electronic workpaper "DR2.001.pdf."

⁶ See WFA/Basin letter to David Konschnik, Attachment 2 at 1-2, copy at WFA/Basin Reply electronic workpaper "BNSF Dec.6 ltr 001.pdf." BNSF subsequently produced a few extraneous documents. These documents do not contain any explanation by BNSF management for its pricing actions. See BNSF/LR 22880 to BNSF/LR 22922.

⁷ See WFA/Basin Op. Narr. at III-H-10 to III-H-13.

B. CONTRACT RATES

Professor Kalt argues that BNSF's imposition of massive rate hikes is commercially reasonable, in his opinion, because WFA/Basin assertedly paid low, "below-market" rates⁸ under the expired LRS transportation contract. Professor Kalt never refers to what "market" he is referring to. Nor does he endeavor to make any comparisons between the LRS contract rates and rates paid by other BNSF customers. Instead, Professor Kalt simply offers a few anecdotal – and mistaken – observations.

First, Professor Kalt opines that the 1984 LRS contract produced "below market" rates because it was the product of a litigation settlement.⁹ The LRS contract was the product of a litigation settlement. However, that fact alone does not mean the LRS contract contained "below-market" rates. During the late 1970's and early 1980's many (if not most) of BNSF's major PRB customers were involved in litigation against BNSF either at the ICC or in the courts.¹⁰ Decisions in these cases, and/or settlements in these cases, were major market factors driving BNSF's PRB coal transportation prices. The LRS case was no different.

⁸ BNSF Op. Narr. at II-24.

⁹ Id.

¹⁰ See, e.g., ICC, 1984 Annual Rep't (April 14, 1985) at 15 ("there still are a significant number of cases involving the maximum reasonableness of rates for the transportation of coal which remain in dispute"), copy in WFA/Basin Reply electronic workpaper "ICC84.001.pdf"; Kansas Power & Light Co. v. Burlington N. R.R., 740 F.2d 780 (10th Cir. 1984) ("KPL") (referencing many court decisions involving western coal rates). A representative listing of reported decisions in some of these cases is appended in Reply Exhibit IV-1.

In the LRS suit,¹¹ WFA/Basin asserted that BNSF had breached a letter agreement setting prices for the LRS service.¹² WFA/Basin also alleged that BNSF had conspired with other western carriers to keep a potential competitor – the ETSI pipeline – out of the western transportation market.¹³ Many other BNSF PRB coal shippers had similar letter agreement cases pending against BNSF¹⁴ and ETSI, along with several PRB coal shippers, had brought antitrust actions against BNSF.¹⁵ The LRS suit, which was filed in Wyoming federal court, settled shortly after the Tenth Circuit (which includes Wyoming) enforced a letter agreement BNSF had entered with another PRB coal shipper.¹⁶ A few years later, ETSI won its antitrust suit against the western railroads.¹⁷

The LRS suit was hardly unique, nor was the end result of that suit unique – a negotiated contract. Professor Kalt's conclusion that the LRS contract rates must be "below-market" because they are the product of a litigation settlement find no support whatsoever in the commercial reality of the PRB coal transportation marketplace in the mid-1980's.

¹¹ Western Fuels Ass'n, Inc. v. Burlington Northern R.R., Civil Action No. C82-0443 (D. Wyo., filed Oct. 22, 1982), copy in WFA/Basin Reply electronic workpaper "LRS Suit.001.pdf."

¹² Id.

¹³ Id.

¹⁴ See KPL, supra.

¹⁵ See ETSI Pipeline Project et al. v. Burlington Northern Inc. et al., Civil Action No. B-84-979-CA, 1989 U.S. Dist. LEXIS 198796 (E.D., Tex decided June 5, 1989).

¹⁶ KPL, supra.

¹⁷ ETSI, supra.

the average R/VC ratios on the LRS traffic exceeded 200%. Overall, BNSF earned over \$311 million in profits during the term of the LRS contract.²⁴ BNSF's profit margins remained high during the twenty year LRS contract term because the rates started at high levels (over 200% of variable costs) and remained high over the contract term because BNSF's costs to provide LRS service decreased.²⁵

The LRS contract trend (decreasing rates and costs) also followed nationwide rail market trends. For example, BNSF CEO Matt Rose informed a Senate Subcommittee in 2001 that "[s]ince 1980 .. rail shippers rates have declined an average 62% (inflation adjusted)."²⁶ Mr. Rose also testified that during this time period, "railroad expenses were reduced even more deeply than rates." Mr. Rose concluded that these results "allowed the industry to gradually shore-up its finances." Id.

Fourth, as demonstrated, Professor Kalt offers no credible evidence to support his opinion that the LRS contract rates were below "market" levels. Instead, the facts show that BNSF has imposed draconian increases on top of extraordinarily profitable contract rates.

C. PRB CAPACITY

Next, Professor Kalt opines that BNSF's rate actions are commercially reasonable because the current "tight capacity for PRB coal" requires BNSF to impose

²⁴ Id.

²⁵ Id.

²⁶ Statement of Matthew K. Rose, President and CEO Burlington Northern Santa Fe Corporation Before the Senate Subcomm. on Surface Transportation and Merchant Marine of the Comm. on Commerce, Science and Transportation (May 9, 2001) at 8, 9, copy in WFA/Basin Reply electronic workpaper "rose.testimony.pdf."

“higher prices” on the LRS movement for it to fund new PRB infrastructure.²⁷ Professor Kalt’s “capacity” argument overlooks the fact that BNSF earned substantial profits under the expired LRS contract. BNSF management was free to utilize these profits as it saw fit – including making investments in its PRB transportation infrastructure.

Professor Kalt’s capacity argument also assumes that BNSF has significant PRB capacity problems and that BNSF lacks funds to expand PRB capacity. Both assumptions directly conflict with the conclusions reached in a recent, authoritative rail infrastructure study prepared by a neutral third party – the American Association of State Highway and Transportation Officials (“AASHTO”).²⁸ The AASHTO study has been cited with approval by many leaders in the freight transportation field, including STB Chairman Nober.²⁹

The AASHTO Study correctly observed that the nation’s rail freight network is properly divided into a series of “unique transportation corridors.” *Id.* at 68. One of these major corridors is the PRB corridor which “extends from the low-sulfur coal fields of the Powder River Basin in northeastern Wyoming to the power plants throughout the Midwest and South.” *Id.* at 117.³⁰ This corridor is “the single largest rail market in

²⁷ BNSF Op. Narr. at II-28, II-31.

²⁸ The study is titled “Transportation – Invest In America, Freight-Rail Bottom Line Report (Jan. 2003) (“AASHTO Study”). A copy of the AASHTO Study is set forth in WFA/Basin Reply electronic workpaper “FreightRailReport.pdf.”

²⁹ See Testimony of Hon. Roger Nober Before the House Committee on Transportation and Infrastructure’s Subcommittee on Railroads (June 26, 2003) at 5-6, copy at WFA/Basin Reply electronic workpaper “Nober.testimony.pdf.”

³⁰ A map of the PRB coal corridor, as set forth in the AASHTO Study, is shown in Reply Exhibit IV-3.

the country” with current traffic levels expected to grow significantly over time.

AASHTO Study at 117. The vast majority of traffic moving in the PRB corridor is unit train coal traffic. Id.

The AASHTO Study found that “there are no significant rail capacity constraints” in the PRB coal transportation corridor “[b]ecause of the volume and profitability of this market:”

Because of the volume and profitability of this [PRB] market, there are no significant rail capacity constraints. From the building of the Powder River line, to triple tracking where the corridor shares assets with transcontinental flows, to upgrading lines to handle 287,000-pound and 315,000-pound cars, the railroads have made the necessary investments.

Id. The Study further concludes that the PRB corridor will continue not to be capacity constrained over the next twenty years because railroads “will remain effective at attracting, retaining, and financing unit train business....” Id. at 93.

The AASHTO Study confirms that BNSF has earned substantial profits on its coal traffic at historic pricing levels. The profits have been more than enough to finance infrastructure growth, and will continue to do so in the future. Professor Kalt’s capacity analysis, like his market analysis, is not supported by the facts and, like his market analysis provides no “commercial” support whatsoever for BNSF’s rate increases on the LRS traffic.³¹

³¹ WFA/Basin note that Professor Kalt predicates this entire capacity analysis on his observation that between 1984 and 2004, PRB coal production “has increased by a factor of four, while [BNSF/UP joint line] track miles have increased by less than a factor of two.” BNSF Op. Narr. at II-30. Professor Kalt’s simplistic observation fails to acknowledge the many additional factors that increase capacity without increasing track-

D. BASIN ELECTRIC'S GENERATING COSTS.

Finally, Professor Kalt opines that BNSF's rate increases are commercially justified because Basin is a "low" cost electric generator and "there is no reason to believe that BNSF's rate increases would make Basin Electric uncompetitive or otherwise cause Basin to curtail usage and power production."³²

Professor Kalt appears to be advocating a "what the traffic will bear" maximum rate standard – i.e. any rate increase is permissible so long as it does not result in a reduction in shipper volume (or BNSF's profits). This standard has never been embraced in the 100+ years of rail rate regulation. As stated by the STB's predecessor, the ICC:

To make rates for transportation based solely upon the ability of the shipper to pay those rates is to make the charge for transportation depend upon the cost of production rather than upon the cost of carriage – to measure a public service by the economies practiced by the private shipper. This necessarily gives to the carrier the right to measure the amount of profit which the shipper may make and fix its rate upon the traffic manager's judgment as to what profit he will be

miles. BNSF itself has long recognized the efforts that have been made to increase capacity in the PRB (as well as other BNSF rail lines) without the addition of sidings or rail line trackage. Capacity-enhancing improvements include the switch to aluminum cars that transport greater payloads, the increase in the weight on rail from 268,000 pounds to 286,000 pounds, longer trains, improved dispatching with more modern centralized traffic control facilities, additions to staging yards, better crew utilization, etc. See e.g., BNSF's 2004 Report to Stockholders at 12 (BNSF highlights its "improved efficiency with longer trains for coal" (copy at WFA/Basin Reply electronic workpaper "BNSF 2004 Ann. Rep._001.pdf"); BNSF's 1996 Report to Stockholders at 3 (discussing BNSF's new information systems for improving train movement and yard operations) (copy at (WFA/Basin Reply electronic workpaper "BNSF 1996 Ann. Rep._ 001.pdf).

³² BNSF Op. Narr. at II-28.

permitted. This theory entitles the railroad to enter the books of every enterprise which it serves and raise or lower rates without respect to its own earnings but solely with respect to the earnings of those whose traffic it carries. This is not regulation of railroads by the nation, but regulation of the industries and commerce of the country by its railroads.

That nothing stands in the way of extortion excepting the fair-mindedness of the railroad traffic manager is illustrated in this case..."³³

Professor Kalt also claims that a "decline" in BNSF's rates has been "one of the factors" contributing to Basin's "bill credits" to its members.³⁴ Basin Electric has distributed bill credits to its members when it has sold more power (and earned more revenues) than the sales revenues it projected in its annual budget forecasts. The credits Professor Kalt references were made in the 1999-2003 time period. These credits were not caused by any "decline" in BNSF's rates since BNSF's average freight rates remained constant, and did not "decline," during this time period. Instead, as Basin Electric reported in its 2003 Annual Report, the credits arose because Basin Electric's "power plants set new reliability and performance records, wholesale markets were strong and [Basin] had surplus power to sell."³⁵

³³ In re: Investigation of Advances in Rates by Carriers in Western Truck Line, Trans-Missouri and Illinois Freight Committee Territories, 20 I.C.C. 307, 350-51 (1911).

³⁴ BNSF Op. Narr. at II-27.

³⁵ Basin Electric 2003 Annual Report at 2.

PART V

WITNESS QUALIFICATIONS AND VERIFICATIONS

This Part contains the Statement of Qualifications of one additional witness who is responsible for a portion of WFA/Basin's Reply Evidence as identified. This part also contains the verifications of two other Reply witnesses, who previously testified on Opening, including references to the specific portions of the Reply Evidence for which each is responsible.

1. DAVID RAATZ

Mr. Raatz is Manager of Marketing and Power Supply Planning for Basin Electric. His business address is 1717 East Interstate Avenue, Bismark, ND 58503-0564. Mr. Raatz is sponsoring the portion of WFA/Basin's Reply Evidence describing certain bill credits made to WFA Basin members, set forth in Part IV, above.

Mr. Raatz has been employed by Basin Electric for 25 years. As Manager of Marketing and Power Supply Planning, Mr. Raatz is responsible for the marketing of Basin's electric sales (including member system and surplus sales). He has held this position for more than eight years. Mr. Raatz is personally familiar with and knowledgeable about the Basin bill credit issues referred to by BNSF in its opening evidence.

LIST OF REPLY EXHIBITS

EXHIBIT II-A-

TITLE

- 1 Detailed Analysis of BNSF's Fuel Consumption & Fuel Price Evidence
- 2 Detailed Analysis of BNSF's Locomotive Spare Margin Procedure
- 3 Comparison of Rates, Variable Costs and Rate-To-Variable Cost Ratios for WFA/Basin Coal Movements from PRB Origins to Laramie River Station -- as Presented in WFA/Basin's Reply and BNSF Open - 4Q04
- 4 Variable Cost Differences by Causal Factor - WFA/Basin Reply vs. BNSF Open, Dry Fork to Moba, WY - 4Q04
- 5 Comparison of WFA/Basin and BNSF Opening Traffic and Operating Characteristics for Movements from PRB to WFA/Basin's Laramie River Station - 4Q04
- 6 Comparison of WFA/Basin Reply and BNSF Open with Agreed-to Traffic and Operating Characteristics for Movements from PRB to WFA/Basin's Laramie River Station - 4Q04
- 7 Reply Variable Costs for Unit Train Movements of Coal via BNSF from Dry Fork Mine to WFA/Basin's Laramie River Station Near Moba, WY -- Base Year 2004 Indexed to 4Q04 Levels
- 8 Reply Variable Costs for Unit Train Movements of Coal via BNSF from Eagle Butte Mine to WFA/Basin's Laramie River Station Near Moba, WY - - Base Year 2004 Indexed to 4Q04 Levels
- 9 Reply Variable Costs for Unit Train Movements of Coal via BNSF from Cordero Mine to WFA/Basin's Laramie River Station Near Moba, WY -- Base Year 2004 Indexed to 4Q04 Levels

- 10 Reply Variable Costs for Unit Train Movements of Coal via BNSF from Caballo Rojo Mine to WFA/Basin's Laramie River Station Near Moba, WY -- Base Year 2004 Indexed to 4Q04 Levels
- 11 Reply Variable Costs for Unit Train Movements of Coal via BNSF from Jacobs Ranch Mine to WFA/Basin's Laramie River Station Near Moba, WY -- Base Year 2004 Indexed to 4Q04 Levels
- 12 Reply Rates, Variable Costs, and Revenue to Variable Cost Ratio – BNSF Origin Mines to WFA/Basin's Laramie River Station – 4Q04

**EXHIBIT
IV**

TITLE

- 1 Representative Reported PRB Coal Case Decisions
- 2 Comparison of Change in Coal Revenues Per Ton Mile (1984-2004)
- 3 American Association of State Highway and Transportation Officials, Freight-Rail Bottom Line Report, PRB Coal Corridor Map

EXHIBIT
II-A-1
REDACTED

EXHIBIT
II-A-2
REDACTED

EXHIBIT
II-A-3
REDACTED

EXHIBIT
II-A-4
REDACTED

EXHIBIT
II-A-5
REDACTED

EXHIBIT
II-A-6
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EXHIBIT
II-A-7
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EXHIBIT
II-A-8
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EXHIBIT
II-A-9
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EXHIBIT
II-A-10
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EXHIBIT
II-A-11
REDACTED

**Reply Rates, Variable Costs, and Revenue to Variable Cost Ratio -
BNSF Origin Mines to WFA/Basin's Laramie River Station - 4Q04**

	<u>Origin Mine</u> (1)	<u>Exhibit Ref</u> (2)	<u>Quarter</u> (3)	<u>Tons</u> (4)	<u>Rate per</u> <u>Ton 1/</u> (5)	<u>Variable</u> <u>Cost</u> <u>per Ton</u> (6)	<u>Jurisdictional</u> <u>Threshold</u> (7)	<u>Ratio</u> <u>Rate</u> <u>to VC</u> (8)
1.	Dry Fork	Reply Exhibit II-A-7	4Q04		\$6.71	\$1.42	\$2.56	473%
2.	Eagle Butte	Reply Exhibit II-A-8	4Q04		6.72	1.47	2.65	457%
3.	Cordero	Reply Exhibit II-A-9	4Q04		6.48	1.28	2.30	506%
4.	Caballo Rojo	Reply Exhibit II-A-10	4Q04		6.53	1.29	2.32	506%
5.	Jacobs Ranch	Reply Exhibit II-A-11	4Q04		6.25	1.22	2.20	512%

1/ Includes fuel surcharge.

REDACTED

Representative Reported PRB Coal
Case Decisions

A. ICC

- San Antonio, Texas v. Burlington Northern, Inc., 355 I.C.C. 405 (1976); 359 I.C.C. 1 (1978); 361 I.C.C. 482 (1979).
- Incentive Rate on Coal – Cordero, WY to Smithers Lake, TX, 358 I.C.C. 537 (1977).
- Incentive Rate on Coal – Belle Are, WY to Council Bluffs, IA, 359 I.C.C. 201 (1978).
- Annual Volume Rate on Coal – Wyoming to Flint Creek, AR, 361 I.C.C. 533 (1979) 364 I.C.C. 753 (1981).
- Arkansas Power & Light Co. v. Burlington Northern, Inc., 361 I.C.C. 504 (1979).
- Unit Train Rates on Coal – Burlington Northern, Inc., 361 I.C.C. 655 (1979).
- Increased Rates on Coal, BN, Montana to Superior, WI, 362 I.C.C. 625 (1980).
- Coal, Colstrip, Kuehn and Decker, MT to Superior, WI, 364 I.C.C. 152 (1980).
- Unit Train Rates on Coal – Burlington Northern, Inc., 364 I.C.C. 186 (1980).
- Coal, Wyoming to Redfield, AR, 364 I.C.C. 988 (1981).

B. Court

- Burlington Northern, Inc. v. United States, 459 U.S. 131 (1982).
- Kansas Power & Light Co. v. Burlington Northern R.R., 740 F.2d 780 (10th Cir. 1984) (“KPL”).
- Iowa Power and Light Co. v. United States, 712 F.2d 1292 (8th Cir. 1983).
- Kansas City Power and Light Co. v. Burlington Northern R.R., 707 F.2d 1002 (8th Cir. 1983).
- Burlington Northern R.R. v. ICC, 679 F.2d 934 (D.C. Cir. 1982).
- Burlington Northern, Inc. v. United States, 679 F.2d 915 (D.C. Cir. 1982).
- Burlington Northern, Inc. v. United States, 661 F.2d 964 (D.C. Cir. 1981).
- San Antonio, TX v. United States, 655 F.2d 1341 (D.C. Cir. 1981).
- Systems Fuels, Inc. v. United States, 648 F.2d 265 (5th Cir. 1981).
- Iowa Power and Light Co. v. Burlington Northern, Inc., 647 F.2d 796 (8th Cir. 1981).
- Iowa Pub. Serv. Co. v. ICC, 643 F.2d 542 (8th Cir. 1981).
- San Antonio, TX v. United States, 631 F.2d 831 (1980).
- Houston Lighting & Power Co. v. United States, 606 F.2d 1131 (1979).
- Burlington Northern, Inc. v. United States, 555 F.2d 637 (8th Cir. 1977).
- Southwestern Elec. Power Co. v. Burlington Northern, Inc., 475 F.Supp. 510 (E.D. Tex. 1979).
- Sunoco Energy Development Co. v. Burlington Northern, Inc., 483 F.Supp. 119 (D. Wy. 1980).

Reply Exhibit IV-1
(page 3 of 3)

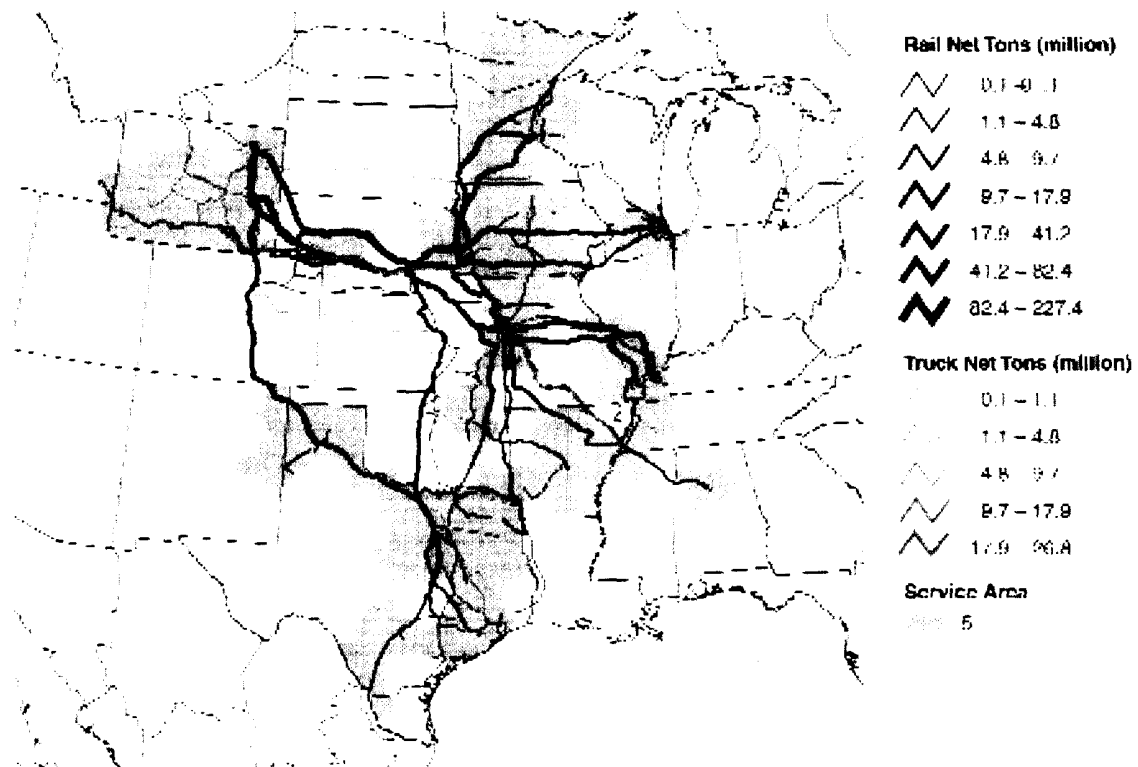
- ETSI Pipeline Project et. al. v. Burlington Northern, Inc. et. al., Civ. Act. No. B-84-979-CA, 1989 U.S. Dist. LEXIS 1987 96 (E.D. Tex. decided June 5, 1989)("ETSI").

EXHIBIT
IV-2
REDACTED

**American Association of State Highway and Transportation Officials:
Transportation – Invest In America, Freight-Rail Bottom Line Report (Jan. 2003)
 (Page 118)**

Figure 54. Powder River Basin Freight Flows

2020 Base Case



Source: Reebie Associates