

UNITED STATES OF AMERICA

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DEPARTMENT OF TRANSPORTATION

SURFACE TRANSPORTATION BOARD

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STB DOCKET NO. 42071

ORAL ARGUMENT IN THE MATTER OF:

OTTER TAIL POWER COMPANY v. BNSF RAILWAY COMPANY

RAIL RATE-REASONABLENESS COMPLAINT

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7th Floor Hearing Room
Mercury Building
1925 K Street, N.W.
Washington, D.C. 20423

Wednesday,
July 27, 2005

The above-entitled matter came on for
hearing, pursuant to notice, at 1:00 p.m., Roger
Nober, Chairman, presiding.

MEMBERS:

ROGER NOBER, Chairman
WILLIAM DOUGLASS BUTTREY, Vice Chairman
FRANK MULVEY, Commissioner

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P-R-O-C-E-E-D-I-N-G-S

1:05 p.m.

CHAIRMAN NOBER: Well, good morning,
everyone. And thank you all for coming.

As you know, today we will hear argument
in another rate-reasonableness case, the Otter Tail
Power Company versus the BNSF Railway Company.

For those of you that aren't familiar, the
case involves a challenge to the reasonableness of
rates for transporting coal from the Powder River
Basin. The shipper has chosen to litigate under the
stand alone cost constraint, which is typical of some
large rate cases here.

Like the rate cases before it, this will
rise and fall on its own merits.

In prior cases shippers have used a
program for modeling the operations at their
hypothetical railroad that the Board found lacking.
But in this case the shipper has used a modeling
program the Board has found acceptable in prior cases,
and BNSF has also employed it. This raises the
question whether the evidence in this case changes the
landscape in some way that entitles the shipper to

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1 more deference on at least some aspects of the case,
2 and that's at least a point we'll be exploring this
3 afternoon.

4 Because the shipper and the railroad have
5 used the same model, we see a emphasis in the
6 arguments. Instead of arguing about whose model works
7 better, the parties now emphasize the inputs to the
8 model.

9 I'll get to the point where we ask you to
10 turn off your cellphones now rather than later.

11 Frankly, I think this is where the
12 battleground should be, and I hope this will result in
13 better, more accurate regulatory decisions.

14 The parties have also raised a number of
15 issues here which we've seen in similar cases, which
16 is the appropriateness of crossover traffic, methods
17 for allocating revenue and the different ways of
18 looking at productivity increases in the rail industry
19 going forward, as well as some new matters as well.

20 Despite having seen some of these issues
21 in the past, I certainly have an open mind in the
22 issues before the case and look forward to exploring
23 some of them today.

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1 Now, a few administrative matters. We
2 will hear from counsel from Otter Tail first, who has
3 40 minutes and it'll be up to Mr. DiMichael to have
4 saved some time for rebuttal.

5 We'll then hear from counsel from BNSF,
6 who has 40 minutes. And after each party's
7 presentation, the Board members will ask questions and
8 we'll do it on a rotating five minute basis.

9 And, as I said before, here is where I
10 normally remind everyone to turn off their cellphones
11 or pagers or put them on vibrate, at the least. And
12 I'm sure that you've all done that by now.

13 So with that, I recognize Vice Chairman
14 Buttrey for any comments he may have.

15 VICE CHAIRMAN BUTTREY: I have no opening
16 statement.

17 VICE CHAIRMAN BUTTREY: Commissioner
18 Mulvey?

19 COMMISSIONER MULVEY: Yes. I want to thank
20 the staff of the Board for giving us a briefing on
21 Otter Tail. It is a very complex case, so there are
22 lots of issues and I'm looking forward to hearing the
23 testimony from the parties today.

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1 Thank you.

2 VICE CHAIRMAN BUTTREY: Okay. Well, with
3 that, Mr. DiMichael, welcome back to the Board. I know
4 you're a frequent litigant here, but the first time in
5 a rate case. Are you going to use all 40 minutes?

6 MR. DiMICHAEL: No, Chairman Nober. I
7 would like to reserve six minutes for rebuttal.

8 VICE CHAIRMAN BUTTREY: Okay.

9 MR. DiMICHAEL: I would also like to
10 introduce to the Board Mr. George Koeck, who is the
11 General Counsel of Otter Tail Power. And he is here
12 because, obviously, Otter Tail is extremely interested
13 in the matter.

14 Otter Tail is a utility headquartered in
15 Fergus Falls, Minnesota. The complaint was filed in
16 January of 2002, but due to the passage of time there
17 has been substantial changes in the evidence. And,
18 Chairman Nober, you noted the fact that the
19 complainant in this case has chosen to use the RTC
20 model upon invitation from the Board. And just so
21 we're all clear here also, although the evidence
22 contains both the string model as well as the RTC
23 model, I will tell you here that Otter Tail in this

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1 case will rely on the RTC model for its operating
2 statistics.

3 That also leads, really, to a second
4 introductory thing here just so, again, everyone is
5 clear. Otter Tail when it had used the string model
6 introduced some certain non-coal reroutes. And when
7 the Board invited Otter Tail to use the RTC model it
8 did not permit Otter Tail to use those reroutes. And,
9 frankly, that is fine. So, again, the state of the
10 evidence will be here that Otter Tail was not relying
11 on its evidence regarding non-coal reroutes. We have
12 attempted, basically, to listen to what the Board's I
13 think clear preferences are.

14 Otter Tail's presentation is in a base
15 case and an alternate case. The base case involves
16 revenue divisions for crossover traffic based upon a
17 market-based division. And the alternate case
18 represents revenue divisions for crossover traffic
19 based upon the MSP formula.

20 The only difference between the two cases
21 is that, as well as there is somewhat more tons in the
22 alternate case than in the base case because we were
23 not able because of the regressions used to use all of

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1 the tons. But aside from that, aside from certain
2 quantities which are driven by the different tons, the
3 two cases are the same.

4 I would want to really emphasize here and,
5 Chairman Nober, basically to reemphasize I guess what
6 you just said. And that is that these cases as we
7 read the Board's decisions are highly factual and are
8 based upon their record. What we've tried to do here
9 is to take a look at the past cases and where the
10 shippers have succeeded or failed in the presentation
11 of evidence. And I will tell you here that I would
12 invite the Board to take a very close look at the
13 record here, because we believe in this case there is
14 substantially better evidence than has been presented
15 in a number of past cases in a variety of areas. And
16 I'll be talking about some of them, but they range
17 from things such as productivity to much more esoteric
18 things as construction allowances and bridges, and
19 things of this sort. But we think we have attempted to
20 meet several of the Board's evidentiary issues that it
21 has identified in past cases.

22 Anyway, what we have here is a map of the
23 Otter Tail railroad, the Otter Tail stand alone

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1 railroad. And as you see, it excludes the -- there
2 was a route there from Glendive north for the non-coal
3 traffic. And this excludes that. So it basically runs
4 from the Converse Yard in the Powder River Basin to
5 the Big Stone Plant.

6 Now, Chairman Nober, you mentioned that
7 both parties have used the RTC model. And that, in
8 one sense, is true. But in another sense there are
9 significant differences. And what I have here is a
10 schematic of the Otter Tail railroad which shows the
11 segments of the Otter Tail railroad that were modeled
12 by BN using the RTC model and the segments of the
13 Otter Tail railroad that were modeled by BN using the
14 RTC model. So there is this very odd sort of two
15 segment using the RTC model and two segment not. And
16 what the BN did for the other two segments is they
17 kind of said, well, Otter Tail's thing is fine. But
18 what BN failed to do then is to properly link the
19 segments and did not show the Board what would happen
20 if you make changes on one segment and how they effect
21 a second segment. So changes that you might make, for
22 example, to the coal as BN did running from Converse
23 Yard to Donkey Creek will have an effect upon the red

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1 segment that BN did not model.

2 So there is, we think, very significant
3 flaws in BN's operating plan here that the Board needs
4 to take cognizance of.

5 The BN used the RTC model here for these
6 two segments, for example, but it did not even in a
7 model several of the yards using the RTC model. So,
8 again, we're talking about major aspects of this
9 operation that was not modeled by BN.

10 BN tries to lay on top of the Otter Tail
11 model, however it's own dwell times and its own yard
12 capacities. But here those dwell times and yard
13 capacities are entirely unrealistic. It says, for
14 example, that things in a yard need to be done
15 sequentially when they really can be done
16 simultaneously. And there are very, very excessive
17 times, for example, in those yards. There is an empty
18 train inspection, for example, in one yard. It's
19 supposed to be taking on average six hours when a much
20 more extensive inspection has just taken place at the
21 Guernsey Yard about 102 miles away.

22 So there's a whole series of things here
23 in which BN's operating plan is severely flawed.

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1 So we think here that this is a case in
2 which clearly the complainant's operating model and
3 operating plan should be adopted by the Board.

4 In fact, if you superimpose BN's yard
5 times and dwell times on Otter Tail's full RTC model,
6 that RTC model will not run again showing the severe
7 flaws in BN's operating model.

8 Let me turn to a question that has been a
9 substantial question in many of these cases.

10 And I would maybe tell the Board here that
11 if the Board would like to ask questions during this
12 time, that is fine. I have no problem with that.

13 But let me turn to a question which has
14 been a major question in all of these cases, and that
15 is the question of revenue divisions and the revenue
16 divisions for crossover traffic.

17 The ICC and the STB up until the Duke case
18 had, we believe, consistently held that a market-based
19 approach to allocate crossover revenues is the proper
20 approach. In, for example Nevada Power II, the ICC
21 declared that "the proper approach to allocate cost
22 over revenue was to estimate what market-based
23 divisions would be, and this will be the standard for

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1 future cases." And while the methodology has evolved
2 over time from a milage-based pro rate to a modified
3 mileage pro rate to the MSP, we believe that the
4 principle involved has always been to try to estimate
5 what market-based divisions would be. This is the
6 very first case in which complainant has given market-
7 based divisions to the Board. Since SARR is a
8 replacement for the BNSF as the PRB an origin carrier
9 for crossover traffic, it steps into the BNSF's market
10 position. And we think evidence about market-based
11 divisions are crucial to allow the SARR to mirror
12 BNSF's conduct when it negotiates with other carriers
13 in the same way that the SARR mirrors BNSF's market-
14 based revenues when it negotiates with its shippers.
15 The SARR assumes that it gets the exact same revenues
16 that the BNSF gets from its shippers as a result of
17 those marketplace negotiations. The same process
18 takes place when BNSF negotiates with its revenue
19 division carriers. And we believe, therefore, that
20 market-based divisions should be used as the best
21 surrogate of that.

22 Now BN has claimed in this case that to
23 use market-based divisions gives the SARR origin

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1 carrier a much too large share of the division
2 revenue. Now, we have distributed to the Board a
3 confidential exhibit that I'm going to discuss only
4 very circumspectly here. But if you take a look at
5 the charts in front of you, and I'm looking basically
6 at the yellow chart, this shows two actual unit train
7 movements of coal. This is a movement that has a
8 short haul carrier in it and it has a long haul
9 carrier in it. And the long haul carrier and the
10 short haul carrier divide the revenue. But as you'll
11 see from the first move, which is the top line of this
12 chart, the short haul carrier actually, even though it
13 has a very small proportion of the miles, gets the
14 majority of the revenue, the actual dollar revenue.
15 And the chart, which is on the top which is a mils per
16 ton mile, shows the huge difference in mils per ton
17 miles that the origin carrier would get, in this case
18 the destination carrier would get, for its short haul
19 move.

20 So the same thing is true of this second
21 move, which is the bottom two charts. It shows again
22 two carriers, one with a long haul move and one with
23 a short haul move, where the short haul destination

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1 carrier is getting the huge proportion of the ton
2 miles, and actually gets a majority of the revenue.

3 So far from not fairly or not accurately
4 portraying what actual divisions are or what the
5 marketplace will show, we think that the Board should
6 follow its precedent that it said in the Nevada Power
7 case and the FMC case and look seriously, rely on
8 market-based divisions.

9 Now, if the Board chooses not to do that
10 and there is, obviously lots of questions in there,
11 but if the Board chooses not to do that --

12 CHAIRMAN NOBER: I'm sorry. Page 2 shows
13 what it would be if we applied MSP?

14 MR. DiMICHAEL: Yes. In fact, I will get
15 to page 2 actually right now. But page 2 actually
16 gets to the question that I'm going to be talking
17 about now, and that is if the Board decides not to use
18 market-based divisions, we believe that the MSP
19 methodology is the best methodology for the Board to
20 use.

21 The BN, however, has said that the Board
22 should attempt to reduce the terminal blocks. And
23 just to set the stage here. The MSP methodology would

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1 give both the origin and the terminal carrier a 100
2 mile revenue block. What the BN said in this case is
3 that the Board should get away from that precedent and
4 should reduce the 100 mile terminal block to simply a
5 25 mile terminal block.

6 Now, there are a number of reasons that
7 this is simply wrong. The 100 mile terminal block has
8 been used by the Board in its Waybill Sample for many,
9 many years. It is actually the basis in the Waybill
10 Sample for dividing revenues between carriers.

11 The Waybill Sample doesn't, as BN would
12 like the Board to do here, is kind of break that 100
13 terminal block into different classes of traffic and
14 have some class of traffic have a 25 miles block,
15 another class of traffic have some other mile terminal
16 block. Well, the Waybill Sample doesn't do that. It
17 treats the traffic as a whole.

18 Now BN's methodology and BN's reasoning
19 for this is absolutely flawed, we think. The BN's
20 analysis only looks at the terminal costs. It
21 therefore, assumes that the line haul costs for this
22 for all these movements and all these kinds of
23 movements are exactly the same. So, for example, a

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1 line haul cost for a unit train movement is the same
2 as the line haul cost for a commodity movement, is the
3 same as a line haul cost for an intermodal movement.
4 But that just simply isn't true that the line haul
5 costs that you have for a coal movement is very
6 different, because of the efficiencies in that is very
7 different than the line haul cost you get, for
8 example, from a merchandise movement of chemical or
9 steel, or whatever. And is very different from the
10 line haul cost that you get out of a very light
11 loading intermodal movement.

12 So one of the key assumptions in the BN's
13 calculation of the 25 mile milage block is simply
14 wrong.

15 A second key assumption in that
16 calculation of the 24 mile milage block is also wrong,
17 and that is BN's assumption that if you move traffic
18 one mile, it is the same cost per mile as if you would
19 move it a 100 miles. But to move that traffic a
20 single mile is not a 100 times the cost -- the cost of
21 moving it 100 miles is not 100 times the cost of the
22 one miles; rather the cost of the first mile is much
23 more proportionally than the cost of the second,

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1 third, fourth, 100th mile. It's a second assumption
2 in the BN's calculation, and that assumption is wrong.

3 Before the Board gets into trying to
4 divide out its Waybill Sample the way the BNSF would
5 have it here, there is some serious issues that the
6 Board needs to take a look at and some serious
7 ramifications. Because the BNSF would basically undue
8 the methodology in the Waybill Sample, it would
9 undermine the Waybill Sample and any derivatives from
10 the Waybill Sample.

11 For example, different carriers have
12 different mixes of traffic, and so therefore things
13 that are based upon the Waybill Sample such as the
14 RSAM and the RVC>180 would have to change. The
15 calculations that the BN used for this are very, very
16 complex and we think that they are wrong.

17 Perhaps, however, the best reason for the
18 Board rejecting the BNSF's attempts to go to a 25 mile
19 milage block was stated by the Board itself through
20 its counsel in a recent case to the D.C. Circuit when
21 the Board was talking about this particular issue
22 about revenue allocation. It said in this brief in
23 the XCEL case: "The burden was on BNSF to make a

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1 convincing showing that its alternative approach was
2 superior to the general approach the agency has used
3 since 1994 as there is a norm of regularity in
4 government conduct that presumes an agency's duties
5 are best carried out if the settled rule is adhered
6 to."

7 If the Board is not going to use what we
8 think is a rule that it's stated in Nevada Power and
9 FMC that it should it consider market-based divisions,
10 it should then at least adhere given the fact that the
11 BN has not at all proven its 25 mile milage block
12 here, it should at least adhere to the 100 mile
13 millage block that it has used for many, many years.

14 Let me turn to an issue which has been a
15 key issue in stand alone cases for a long, long time
16 and that is the issue of the RCAF-A and the RCAF-U
17 productivity.

18 The Board has used the RCAF-A and the
19 RCAF-U -- the Board has attempted to decide between
20 using the RCAF-A and the RCAF-U in these cases for
21 several cases now. And it has decided to use the RCAF-
22 U because it says that although we believe that there
23 will be some productivity gains for a stand alone

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1 railroad, they will not be we think as much as a
2 normal carrier as an existing carrier because the
3 stand alone railroad is starting out with the most
4 efficient railroad.

5 Now, in this case we have identified
6 specifically -- let me just stop. In past cases
7 basically what the shipper has said in that case is
8 that, of course, there's going to be productivity.
9 This railroad industry has had productivity for years
10 and there's no reason to believe that the SARR will
11 not have productivity. And the Board has said well
12 that's simply not good enough.

13 But what we have done in this case is to
14 identify in the record specific things that have been
15 stated in the literature. And if you look in the
16 record, there's literally an inch or two of articles
17 that have identified specific aspects of productivity,
18 and some of them you see right over here. They not
19 only identify specific places where the industry, the
20 literature in the industry specifically believes that
21 productivity will take place, but these articles also
22 identify when that productivity gain is likely to
23 occur.

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1 Now BNSF in this case has said that, look,
2 most of the productivity in the railroad industry
3 comes from long lived assets that will never be
4 replaced in the SARR until after the 20 year period.
5 But if you take a look at this list, that is simply
6 not true. In fact, virtually all of these will take
7 place as the literature states between the year 2002
8 when we began collecting these and 2007. Things like
9 microprocessors. Things like top-of-rail lubrication.
10 You can just simply read right down there, and I know
11 the staff will be delving deeply into this. But these
12 are many, many things that can be either done right
13 now or that will be expected to be done very near
14 future.

15 Moreover, even for longer lived assets
16 there is going to be productivity. For example,
17 locomotives. Locomotives, obviously, last a fair
18 amount of time. But SARR, an Otter Tail SARR like the
19 BN, leases its locomotives. And those locomotives
20 contain lease provisions which permit BN and permit
21 the SARR to turn those locomotives back or to sell
22 them after five years in certain circumstances. So
23 the SARR will have exactly the same options that the

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1 BN itself does to make the productivity gains even on
2 longer lived assets.

3 Now let's talk about real long lived
4 assets such a track. The SARR has been built to carry
5 traffic that is going to take place, not in the year
6 2002 when the SARR began, but in the year 2022. In
7 other words, the SARR has been sized, the capital
8 investments of the SARR have been sized to carry
9 traffic all the way 20 years in the future. The
10 traffic carried now by the SARR is much lower.

11 So, in other words, there is going to be
12 productivity gains as the Otter Tail railroad grows in
13 to its traffic base, the same way that there has been
14 productivity gains in the railroad industry over the
15 past 20 years as the railroad industry has grown in to
16 its traffic base. In fact, we think it is logical to
17 believe that the SARR will have greater productivity
18 gains in industry, which is now according to all
19 accounts, become capacity constrained. The SARR is
20 not capacity constrained. It is sized for the year
21 2022, not for the year 2002.

22 So no matter what categories of assets you
23 take a look at there is the likelihood that the SARR

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1 will have substantial productivity gains. And we think
2 the RCAF-A should be used. At the very least we
3 think what the Board should do here is to use if it
4 does not wish to whole hog, so to speak, it should at
5 least use the RCAF-U only for the first several years
6 of this SARR. And in the year 2008, which is in the
7 record as all of these things will have taken place by
8 then in the year 2008, then to begin to use the RCAF-A
9 at that point.

10 Let me turn to one other issue that has
11 been a very controversial one before the Board, and
12 that is the PPL test. I will start out by saying that
13 Otter Tail disagrees with the logic and the law behind
14 the PPL test. And we do not think it is formulated
15 the proper way.

16 Having said that, Otter Tail for at least
17 the purposes of the calculation has accepted what the
18 Board has done. And we will tell you that despite the
19 logical and legal problems we see in the PPL test, in
20 a sense those can be overleaped because the Otter Tail
21 railroad passes the PPL test, as the Board itself has
22 formulated it. So we here think the PPL test has been
23 satisfied.

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1 Now the BN, however, has suggested in this
2 case that Board should apply the PPL test not just
3 once, but twice. It should apply the PPL test, first
4 of all, in taking a look at the real world rate levels
5 that take place when the cases were first filed. And
6 then should apply the PPL test a second time at the
7 rate prescription stage.

8 The BN incorrectly assumes at this second
9 time that the SARR will not receive full market rates
10 from non-issue traffic. Now let me explain.

11 The PPL test was designed, as we
12 understand the Board, to ensure that real world rate
13 levels do not result in a cross-subsidy; real world
14 rate levels for all the traffic, for Otter Tail's
15 traffic and for all of the other traffic. And the PPL
16 test is applied to these real world rate levels. And,
17 in fact, the underlying question on the PPL test is
18 whether the SARR would extend in this case the
19 north/south line to the east/west line on the basis of
20 the real world rate levels.

21 Now, when it gets to the rate prescription
22 stage, however, what you've got it that although the
23 percent reduction that results in the rate

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1 prescription is calculated on the basis of the entire
2 SARR group. That percent reduction is applied to a
3 single shipper. In this case it would be Otter Tail
4 Power. It is not applied to any other shipper on the
5 SARR. Let's say Otter Tail gets a 25 percent rate
6 reduction in this case, there is no other shipper out
7 there who can come to the Board and say well, you
8 know, Otter Tail got a 25 percent rate reduction and
9 I know that I'm a part of an Otter Tail group, so I'd
10 like the 25 percent rate reduction, too. You order
11 the BN to do that for me right now. That's not how it
12 works; that shipper has to come in and prove its own
13 case.

14 So as a matter of fact for all of the non-
15 issue traffic, the non-issue traffic is not reduced.
16 The only rate that is in fact reduced is the Otter
17 Tail rate.

18 So if the Board wants to accept the logic
19 of the PPL test and if the Board wants to accept the
20 logic of the PPL test at the rate prescription stage,
21 the PPL test should be applied by reducing only Otter
22 Tail's rate and then the second time PPL test could be
23 run. But there is no reason to assume that the rate

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1 reduction would apply not just to Otter Tail, but to
2 everyone else in the group. That simply is not the
3 case. The SARR is expected to have the same options
4 that the BNSF has. Even if Otter Tail gets a rate
5 reduction, the BNSF after this case will continue to
6 get the same market rate levels from all of the other
7 traffic that it gets now. So it would be incorrect to
8 reduce the other rate levels and then run the PPL test
9 there. At the most you should do is to reduce only the
10 Otter Tail rate and run the PPL test at that time.

11 CHAIRMAN NOBER: You can keep going.

12 MR. DiMICHAEL: Okay.

13 Let me turn to a couple of quick issues
14 here that are important in the overall scheme of
15 things, however.

16 Southern Power River Basin traffic. BNSF
17 has said that there is Southern Power River Basin
18 traffic that moves southward from some of the mines
19 and that traffic does not share facilities, BNSF says,
20 directly with the issue traffic and therefore it
21 should be excised. But there is no requirement. BNSF
22 has completely misread PPL. There is no requirement
23 that all the crossover traffic must share facilities.

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1 What PPL says is that a complainant may not
2 arbitrarily shift attributable costs to traffic that
3 does not share facilities with the issue traffic.
4 Basically if you pass the PPL test, you show that the
5 complainant does not shift attributable cost to
6 traffic that does not facilities with the issue
7 traffic.

8 This issue about the Southern Power River
9 Basin traffic has been basically decided. It has been
10 decided by, first of all, the PPL test. If you pass
11 the PPL test, you pass whatever standard the Board has
12 in this. And it has also been decided in the Duke CSX
13 case where you had exactly the same, in fact if
14 anything even a more extreme case where the
15 complainant's traffic did not even reach to the point
16 where the non-issue traffic was. And the Board
17 accepted that traffic there.

18 So although BN makes a major point of
19 this, we think that this is settled both with the PPL
20 test as well as in the Duke CSX case.

21 Let me talk about one other issue here,
22 and that is regarding debt costs. Consistent with STB
23 precedent, Otter Tail has updated its cost of debt to

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1 reflect the fact that the SARR would have refinanced
2 its debt in 2003. As I mentioned before, this case
3 began in January of 2002. The case continued long
4 enough to see substantial declines in the cost of debt
5 over that period.

6 And as far as precedent goes, the STB and
7 the ICC before it have routinely updated cost of
8 capital in other areas and in other decisions. The
9 Board has routinely updated things like projections,
10 for example EIA projections to take into account the
11 most recent projections. And in WTU the Board has
12 said that it would expect a SARR to refinance itself
13 if interest rates dropped.

14 In this case interest rates have dropped,
15 not after the decision but they've actually dropped
16 during the case. And we think it makes perfect sense
17 and is perfectly consistent with STB precedent to have
18 the SARR refinance its debt, just like probably --
19 well, lots and lots of homeowners in the country have
20 done, and in fact BN itself has done.

21 CHAIRMAN NOBER: Do you want to reserve
22 the balance of your time or --

23 MR. DiMICHAEL: Let me hit one last issue

1 here.

2 CHAIRMAN NOBER: Okay.

3 MR. DiMICHAEL: And that is maintenance of
4 way. The major difference between BNSF and the SARR
5 and the Otter Tail SARR in the maintenance of way area
6 has been in the SARR's use of contract employees to
7 make maintenance of way to do maintenance of way
8 program maintenance.

9 The STB in the TPMA case rejected the
10 notion that there could or there even could be a
11 maintenance of way that is out sourced like that. In
12 this case, however, Otter Tail again has submitted
13 evidence showing that a very large class III
14 RailAmerica out sources 95 percent of his program
15 maintenance. So that what we have here then is a
16 evidentiary record that, unlike the facts that were
17 present in the TPMA case, shows that it is possible.
18 So at the very least the Board should take into
19 account the possibility of that and then take a look
20 at the individual aspects of the maintenance of way
21 costs to see if that element makes sense.

22 Now we say it does make sense. And if you
23 look at this particular slide here this shows from the

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1 record various standards for maintenance of way. The
2 average route miles per field person. Now BNSF's
3 figures show only 2.6 route miles per field person for
4 the Otter Tail SARR, whereas the real world BNSF
5 itself has more people; 3.8.

6 Otter Tail has evidence in the maintenance
7 of way area that WRPI had 5.8 route miles for a
8 person. And the Otter Tail railroad is certainly not
9 very much above that.

10 In other operating costs here, the
11 operating maintenance cost per track mile and the spot
12 maintenance percentage. The real world BNSF in
13 operating maintenance cost per track mile is \$14,000.
14 Otter Tail's railroad is \$14,500. So the combination
15 of the RailAmerica in evidence as well as these clear
16 standards that Otter Tail meets and that BNSF does
17 not, or the BNSF evidence does not, clearly suggests
18 that the Otter Tail maintenance of way evidence should
19 be credited here and should not be simply dismissed,
20 but rather gone into in a very deep detailed way.

21 And with that, I thank the Board.

22 CHAIRMAN NOBER: Thank you.

23 How much time did he use?

1 UNIDENTIFIED SPEAKER: He's still got six
2 minute.

3 CHAIRMAN NOBER: Six minutes. Okay.

4 Vice Chairman Buttrey, do you want to
5 start?

6 VICE CHAIRMAN BUTTREY: I think I'm going
7 to reserve my questions to the end.

8 CHAIRMAN NOBER: Okay.

9 COMMISSIONER MULVEY: Let me spell some
10 questions looking backwards.

11 This difference between Otter Tail and
12 BNSF Otter Tail and your SARR and BNSF's SARR, they're
13 pretty substantial. But does that reflect any kinds
14 of differences in geography that would apply to this
15 route as compared to the overall BNSF system? The
16 overall BNSF, I believe, refers to the entire network,
17 right?

18 MR. DiMICHAEL: Yes. The overall BNSF
19 would refer to the entire network. But if you go back
20 to the slide. Certainly the WRPI would be actually
21 more comparable to the Otter Tail railroad than almost
22 anything. WRPI was basically a coal only railroad, as
23 the Otter Tail has been configured now that we've

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1 dropped out the non-coal traffic. It is basically a
2 coal only railroad also.

3 So on this we think the average route
4 miles per field person, the WRPI is a lot like this.

5 In terms of the other things, we think
6 that a coal only railroad would be actually easier in
7 terms of organizing the maintenance than you would if
8 you would have all sorts of traffic that would have
9 different effects.

10 COMMISSIONER MULVEY: I notice, operating
11 maintenance cost per track mile versus average route
12 miles per field person, would the route miles be less
13 because the SARR in this case, the coal rail, would be
14 double tracked?

15 MR. DiMICHAEL: Yes.

16 COMMISSIONER MULVEY: And so therefore,
17 again, looking at the average for the system as a
18 whole you would expect there to be more route miles
19 because it's single track in many cases, whereas as
20 double track route miles are necessarily going to be
21 different, no?

22 MR. DiMICHAEL: That's right.

23 COMMISSIONER MULVEY: Okay. You had chart

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1 there on expected productivity gains.

2 MR. DiMICHAEL: Yes.

3 COMMISSIONER MULVEY: And you're referring
4 to the literature. I was wondering if that
5 literature, is that the study done by Steve Ditmeyer
6 recently and presented by the National Defense
7 University not so long ago?

8 MR. DiMICHAEL: I don't know if that is in
9 there, but I can tell you that it's not a single
10 study. There is literally, oh I don't know, probably
11 18 or 20 different pieces of literature from various
12 publications.

13 COMMISSIONER MULVEY: That particular
14 study outlined about 25, I believe, something like 25
15 technologies that are on the horizon which could
16 greatly improve railroad productivity over the next
17 decade or 20 years or so. However, the article also
18 makes clear that it's unlikely that many of these are
19 ever going to be instituted or only going to be
20 instituted with great difficulty overcoming
21 resistance. And some of the ones that you have on
22 there, like positive train control, are ones that the
23 railroads are not at this point eager to invest in,

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1 rightly or wrongly.

2 So when you say that these would be in
3 effect by 2008, I'm not sure that the evidence is
4 there to support that most of these technologies would
5 in fact be implemented anywhere near the 2008 time
6 frame.

7 MR. DiMICHAEL: Well, the literature that
8 we have would suggest that these are feasible to be
9 done by then, and I think it would be fair to say at
10 least some of them, in fact many of them, would be
11 expected to be done by then. So I don't know
12 specifically a study that you're talking about. But
13 I think here that there's certainly evidence in the
14 record that would suggest that there is substantial
15 productivity gains fairly early on in the system and
16 that don't depend upon long lived assets.

17 COMMISSIONER MULVEY: No. It depends upon
18 rational behavior, but that may be difficult to
19 achieve.

20 MR. DiMICHAEL: And perhaps just on that
21 point not on rational behavior, but the SARR is at
22 least some of the reasons why a real world railroad
23 cannot access, perhaps, some of these is because it

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1 has a history that includes union contracts and, for
2 example, other things but I'm especially thinking of
3 that that limit its ability to do that. Now the SARR
4 is a lease cost most efficient railroad not burdened
5 by that. So to the extent that some of these things
6 can't be done because of those sort of existing
7 constraints, the SARR is not limited.

8 COMMISSIONER MULVEY: Okay.

9 CHAIRMAN NOBER: Let's start with the
10 first point, which is the one I raised in my opening
11 statement which is, you know, the Board has never
12 accepted a shipper's operating plan before. And I
13 don't know what we'll do with this case. But for the
14 sake, just hypothetically, let's assume for the moment
15 we were to assume a shipper's plan. What level of
16 deference would go along with that? What of the
17 component parts of that should we accept, which of the
18 parts that BN challenges should we look at? How
19 should the Board view an operating plan in that
20 circumstance, which is a matter of first impression
21 for us, were we in the hypothetical to find that?

22 MR. DiMICHAEL: I think there are two
23 aspects of this, I think, with an operating plan. An

1 operating plan will develop for you the operating
2 statistics. Basically the unit numbers and then you
3 have to multiple those unit numbers by the costs of
4 the various units.

5 I would think that if you would adopt the
6 operating plan, it certainly means I believe that you
7 would have to give a considerable amount of deference
8 to the operating statistics because those really flow
9 directly from the model. And the acceptance of the
10 model of the plan really goes along with that.

11 I think you also would have to defer
12 strongly then to things that sort of directly relate
13 to the operating statistics, like for example the
14 dwell time and the yard capacity. Because you can't
15 split the model like that up if the model runs with
16 certain configuration and a certain yard capacity, as
17 long as you believe that that yard capacity and the
18 dwell time seem to be fairly reasonable, the model
19 runs. And so I think it would mean that you would
20 have a certain amount of deference given to those
21 things, too.

22 CHAIRMAN NOBER: So what does that mean
23 for questions, my last question, for issues like dwell

1 time and yard size, for example, if we were to assume
2 your operating plan worked and BNSF said well, yes,
3 but we think these two parts don't, should yours
4 deference?

5 MR. DiMICHAEL: Yes, I do. Because it
6 seems to me that that flows directly from the
7 operating plan.

8 And I think the way that you put it,
9 Chairman Nober, is correct. I think there's a certain
10 amount of deference. I'm not going to tell you that
11 you couldn't decide on something else. But I think we
12 have here not only a workable operating plan, but also
13 substantial evidence that would show that the dwell
14 times and the yard capacities that we have calculated
15 are in fact feasible, are in fact real in the real
16 world. And it seems to me if you put those together,
17 the deference then I think rises to a very large
18 extent.

19 CHAIRMAN NOBER: Then sort of the flip
20 side of that is what level of evidence would the
21 defendant railroad have to put in to contradict that?
22 Do they have to have an entire operating plan that
23 works? Can they have pieces of it and show that these

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1 pieces work or don't work?

2 MR. DiMICHAEL: We think that the way BN
3 has done this in this case where they basically
4 segmented the railroad and given you a model for two
5 unconnected segments to the railroad, frankly cannot
6 be adopted here. It simply does not work. It does not
7 provide you with a rational basis for developing an
8 operating plan.

9 So I think, obviously, the flip side to
10 that is if you believe that the Otter Tail operating
11 plan based on the RTC model a full railroad operating
12 plan with reasonable yard times and dwell times work,
13 it seems to me that is the end to that question.

14 CHAIRMAN NOBER: Commissioner Buttrey.

15 VICE CHAIRMAN BUTTREY: Back on the
16 operating costs side of the ledger, so to speak. I'd
17 just like to get some things in the record if we could
18 about costs.

19 Would you agree to stipulate for the
20 record that wages and salaries at the railroads and at
21 power company are higher or as high as they've ever
22 been?

23 MR. DiMICHAEL: I don't think I could

1 stipulate to that because I don't know and I --

2 VICE CHAIRMAN BUTTREY: Okay.

3 MR. DiMICHAEL: -- wouldn't hazard a
4 guess.

5 VICE CHAIRMAN BUTTREY: I would guess that
6 they might be.

7 It seems that health care costs are going
8 up for everybody. Coal and gas costs are going up for
9 everybody. Construction costs are going up for
10 everybody. Maintenance costs are going up. Taxes are
11 going up. Cost of capital, other things. But it's in
12 the record that the railroad actually came in with an
13 offer to the power company that reduced what you'd
14 been paying in the past, a reduction in your rates.
15 We're not allowed to talk about the amount, nobody is,
16 but it's my understanding and based on the record that
17 the railroad actually came in given those facts and
18 circumstances and offered you a rate that was less
19 than what you had been paying. And I don't know at
20 the moment how long you had been paying the rate that
21 you had been paying. And I think we can say for the
22 record, I believe we can, that the railroad in this
23 case is not revenue adequate at the moment. I believe

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1 that's the case.

2 I just want to make sure that you and the
3 power company and everybody understands that the Board
4 could come in a with a rate prescription that's higher
5 than the last offer from the railroad. Is that clearly
6 understood by everybody?

7 MR. DiMICHAEL: Absolutely.

8 VICE CHAIRMAN BUTTREY: Okay.

9 MR. DiMICHAEL: But I would like to
10 respond to that question if I may, Vice Chairman
11 Buttrey. Because I think this all depends I think on
12 where you start.

13 Otter Tail has been paying a rate like
14 this for a long time. And it is believed that the rate
15 it has been paying for a long time is unreasonably
16 high.

17 Over ten years ago, over ten years ago
18 Otter Tail attempted to build out to escape its
19 captivity from the BN because it thought it was paying
20 a rate that was too high. BN sued Otter Tail to
21 prevent the build it. It successfully sued Otter Tail
22 to prevent the build out and to basically maintain its
23 monopoly position. Since that time, that occurred in

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1 1998, Otter Tail has attempted to negotiate with the
2 BN, win/win negotiations and all other kinds of
3 negotiations. And it has failed. It has not been able
4 to succeed getting a rate that it believes it should
5 have.

6 Otter Tail is now before this Board
7 because this Board is the last place it can come to
8 get the rate relief that it believes it should have.
9 And I guess the question that you may ask well why is
10 it doing this? Why is it spending so much time and
11 effort to get rates that it believes are reasonable?

12 I would suggest to you the answer to that
13 question can be answered by simply a flight into
14 Fargo, North Dakota within Otter Tail's territory.
15 It's in some ways a very pretty territory, but there
16 isn't much there. It's a rural territory. It is a
17 desperate --

18 CHAIRMAN NOBER: I've done it.

19 MR. DiMICHAEL: I know you've done it.

20 CHAIRMAN NOBER: I've done that.

21 MR. DiMICHAEL: And you can see that it
22 desperately needs economic development. Otter Tail's
23 corporate strategy for the last 10 or 15 years has

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1 been to try to develop the area economically. And a
2 key aspect of that is reasonable utility rates which
3 depend upon reasonable rail rate. So this statute, I
4 believe, is not just a question of the economic health
5 of the railroad. It is also a question of economic
6 health of the customer. And what Otter Tail is doing
7 here is attempting to reasonable rail rates so it can
8 support a corporate strategy that is trying to get
9 economic development in that area.

10 CHAIRMAN NOBER: Commissioner Mulvey?

11 COMMISSIONER MULVEY: Let me follow-up on
12 that for a moment. You said that you tried to do a
13 build out to escape captivity. And build outs are
14 legal, and other shippers have proposed, some have
15 even done them. What is the bases of being in that
16 suit to stop you from doing the build out? Was it
17 that you would be violating the contract, your
18 contract with them?

19 MR. DiMICHAEL: No. What happened here,
20 it was not violating our contract. One of the key
21 aspects of the build out was to build to a short line
22 rail carrier about five or six miles away. Otter Tail
23 believed that the short line railroad could serve it

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1 over certain rights that that short line had over the
2 BN. BN sued Otter Tail for tortious interference
3 because it said that the short line railroad could not
4 in fact serve the Otter Tail plant. And the court
5 eventually agreed with the BN on that.

6 So the only build out possibility there is
7 now is about a 25 mile build out to a long line.

8 COMMISSIONER MULVEY: So this was a paper
9 barrier that was in your contract?

10 MR. DiMICHAEL: Yes.

11 COMMISSIONER MULVEY: Yes. Another good
12 example of the usefulness of those.

13 You mentioned about the maintenance of
14 way and there is substantial evidence now from the
15 railroad that is serving the Powder River Basin that
16 the cost of maintaining the infrastructure there is
17 much higher than elsewhere because of fugitive dust.
18 And have you taken that into your account in your
19 calculations of maintenance of way costs?

20 MR. DiMICHAEL: I will tell you that I'm
21 not quite that into the record of being able to tell
22 you whether it takes into account fugitive dust. And
23 the record would have to speak for itself on that.

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1 COMMISSIONER MULVEY: You also mentioned
2 about using the RailAmerica model with regard to
3 maintenance of way and contracting out. But, of
4 course, there's always the issue of whether or not
5 contract services perform as well as that performed by
6 the traditional brotherhoods. And so there's always
7 a question as to whether or not you're getting the
8 same quality work for the buck. So that's always an
9 issue when you're talking about reducing costs through
10 contracting out to maintain the same quality.

11 MR. DiMICHAEL: Well, at least the article
12 that we submit, the evidence that we submit about the
13 RailAmerica's President is quoted in that as saying
14 that they are very happy. They have been able to save
15 a substantial amount of money.

16 COMMISSIONER MULVEY: Okay. One more
17 thing, and that was early on in your presentation you
18 mentioned some regression analysis and you couldn't do
19 some capacities because of differences in the
20 regression analysis. What regression analyses are
21 those?

22 MR. DiMICHAEL: What we did here is when
23 we were taking a look at using market-based divisions,

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1 because of the limitations of the data we were given
2 we had a cut-off on the data that we did not use any
3 movements below a certain percentage of miles. And
4 then it was basically a regression for the movements
5 that we had above that. Because when we put the
6 alternate case in on the basis of the MSP, we didn't
7 have to rely on that basically artificial cut-off
8 because we were not being limited by the data that BN
9 gave us. So that was the difference between the two.

10 COMMISSIONER MULVEY: Okay. Thank you.

11 CHAIRMAN NOBER: All right. Let's turn to
12 the productivity, which is something that has come up
13 in many cases and we've asked a lot of questions about
14 up here and we still seem to be having a hard time
15 getting, you know figuring out what the right thing to
16 do on this is.

17 Now, first of all, I want to appreciate
18 your putting up the evidence that you have on this.
19 And I guess the question I have is what goes into the
20 RCAF-A? I mean, what is it made up of? Is it
21 extrapolating past productivity increases into the
22 future? Is it looking at what are productivity
23 increases that are likely to come into the future? I

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1 mean, what is it made up of?

2 MR. DiMICHAEL: It is a total factor
3 productivity measure taking into account all
4 productivity factors basically looking at input versus
5 output.

6 The RCAF-A is calculated, I believe, on
7 the productivity per year over the last, I believe
8 it's 4 years, it might be five. I'm not sure. And so
9 the figure that the STB uses right now for, let's say,
10 2000 --

11 CHAIRMAN NOBER: But we don't calculate
12 it. It comes from someone else.

13 MR. DiMICHAEL: Well --

14 CHAIRMAN NOBER: I mean, doesn't an
15 outside group do the actual inputs? Not us. I don't
16 think this is one of our measures. We don't forecast
17 it, but we get it.

18 MR. DiMICHAEL: No, you don't. But --

19 CHAIRMAN NOBER: So the actual inputs are
20 not ours.

21 MR. DiMICHAEL: Yes.

22 CHAIRMAN NOBER: I mean, we crunch the
23 number but we don't --

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1 MR. DiMICHAEL: You crunch, right. But in
2 other words, it is not really a forecast of
3 productivity, and it is an average of the past several
4 years of productivity which then are basically assumed
5 to be truly for the coming year. And it is,
6 therefore, a moving average. So you don't in a sense
7 say well we're going to stand here in the year 2005
8 and we're going to guess what productivity is going to
9 be in the year 2005 and 2006. You rather look
10 backwards to the last three, four, five years;
11 whatever it is. I said I think it's four. And you
12 basically average the productivity and that's the
13 productivity adjustment that you put in this year's
14 RCAF.

15 CHAIRMAN NOBER: But at some point we have
16 to project out 20 years, right?

17 MR. DiMICHAEL: Well, yes. Now here --

18 CHAIRMAN NOBER: So then we have to make
19 an extrapolation then what's the productivity going to
20 be in the future and base it on the past.

21 MR. DiMICHAEL: Yes.

22 CHAIRMAN NOBER: Is that correct?

23 MR. DiMICHAEL: That's right.

1 CHAIRMAN NOBER: So we're looking at what
2 is the past productivity gains and then extrapolating
3 those into the future?

4 MR. DiMICHAEL: That's correct.

5 CHAIRMAN NOBER: Now do we think the
6 railroads will continue to get productivity increases
7 in the future at the rate they have in the past?

8 MR. DiMICHAEL: I think that is --

9 CHAIRMAN NOBER: And that's what we have
10 to find, right?

11 MR. DiMICHAEL: Right.

12 CHAIRMAN NOBER: I mean, forget whether or
13 not you get them, would any railroad get the same
14 amount of productivity increase in the future that
15 they've gotten in the past?

16 MR. DiMICHAEL: Well, but in a sense --

17 CHAIRMAN NOBER: I'm going to ask them
18 that.

19 MR. DiMICHAEL: You're answering that
20 question yes right now; that when you look in the year
21 2005 you're not looking in productivity. You're not
22 calculating productivity in the year 2005. What
23 you're doing is you're saying --

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1 CHAIRMAN NOBER: What's the rolling
2 average for the last four years?

3 MR. DiMICHAEL: -- what is the rolling
4 average of the last four years, and that's what we're
5 going to assume. Because that's been the rolling
6 average for the past four years, that's what we are
7 assuming is going to be taking place this year.

8 CHAIRMAN NOBER: Are productivity
9 increases going up or down in the rail industry if you
10 compared the last five years to, say, ten years ago?

11 MR. DiMICHAEL: If you compared the last--
12 my cost consultant is probably going to kill me for
13 trying even to guess this. But I believe that the
14 productivity gains if you would compare with the last
15 five years with maybe ten years ago, they are not as
16 great as the were ten years ago.

17 CHAIRMAN NOBER: So, again, that's getting
18 to the question I'm asking. Putting aside whether
19 Otter Tail railroad ought to get productivity
20 increases, are all productivity increases in the rail
21 industry diminishing. I mean, maybe they've in the
22 past extracted the most productivity increases they
23 can and the gap between A and U is going to narrow in

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1 the future, but our projections if we're projecting it
2 based on the last four years wouldn't show that.
3 They'd show them in straight lines, whereas the
4 reality might be that they're coming together making
5 this -- sort of obviating the problem.

6 MR. DiMICHAEL: I mean, there has been
7 substantial --

8 CHAIRMAN NOBER: I mean, it's going to be
9 such an issue at least I'll understand how we do these
10 calculations.

11 MR. DiMICHAEL: Well, I don't think it is
12 correct to assume that productivity gains in the
13 future are going to be less than productivity gains in
14 the past. The railroad industry --

15 CHAIRMAN NOBER: But they might. I mean,
16 why would we assume that?

17 MR. DiMICHAEL: Well, because for example
18 out there there is the very real possibility that over
19 the next 20 years, certainly over the next 10 or maybe
20 10 to 20 years, the railroad industry will move from
21 two crew trains to one crew trains. If you do that, it
22 cuts your crewing by 50 percent. It's a huge
23 productivity gain.

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1 CHAIRMAN NOBER: Correct. Which you would
2 get because that's a federal rule, not a union
3 contract?

4 MR. DiMICHAEL: That's right.

5 CHAIRMAN NOBER: You can keep talking.

6 MR. DiMICHAEL: Well, what I'm saying is
7 that there is I don't think anything out there to
8 assume that especially the productivity gains that
9 we're seeing now will just not possibly be able to
10 take place in the future. That risk tends to suggest
11 that there is substantial productivity gains and even
12 things that are just sort of out there would suggest
13 that there is certainly the possibility of
14 productivity gains. No one knows whether there's
15 going to be productivity gains great or less or the
16 same now as there is ten years from now. That's just
17 simply unknowable. All we can do is take a look, as
18 the Board does with it RCAF-A. Look at recent past
19 and project that out.

20 And the same way with the RCAF-U.

21 CHAIRMAN NOBER: Okay. I'm sorry. If I
22 could indulge one more question.

23 When you say that you get more use out of

1 the same amount track, that's measured as a
2 productivity increase if you're getting more revenue
3 ton miles per mile of track on an annual basis; that's
4 treated as a productivity increase?

5 MR. DiMICHAEL: There is more output for
6 the same amount of input, yes.

7 CHAIRMAN NOBER: I mean, that doesn't
8 mean--

9 MR. DiMICHAEL: In other words, through
10 higher volume --

11 CHAIRMAN NOBER: So you utilizing excess
12 capacity by increased volume is a productivity -- you
13 measure that as a productivity increase?

14 MR. DiMICHAEL: Absolutely. Because what
15 you're doing is you are putting more tons, for
16 example, on the same amount of cost. Your unit costs
17 are going --

18 CHAIRMAN NOBER: But carriers are now are
19 probably capped out at that. So does that make up a
20 large portion of what the productivity increases have
21 been in the past?

22 MR. DiMICHAEL: In other words what we're
23 saying is the Otter Tail railroad is --

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1 CHAIRMAN NOBER: Could get that?

2 MR. DiMICHAEL: Could get more because it
3 is not, perhaps, capped out the same way that a
4 present day railroad is. So if a present day railroad
5 is, for example, capped out then the Otter Tail
6 railroad we think there is a very good possibility
7 that the Otter Tail because it's not capped out will
8 actually have more productivity gains than the
9 railroading industry now.

10 CHAIRMAN NOBER: If it just fills up its
11 capacity?

12 MR. DiMICHAEL: If it simply just fills
13 its--

14 CHAIRMAN NOBER: And volumes continues to
15 go up?

16 MR. DiMICHAEL: Capacity. If it simply
17 just gains productivity just purely because of that.

18 VICE CHAIRMAN BUTTREY: You mentioned a
19 customer base just a few minutes ago. I'm just
20 curious. Are your customers captive to you in your
21 market? Do they have other alternatives for getting
22 power someplace else?

23 MR. DiMICHAEL: Yes, they are captive to

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1 us in our market, although because of federal rules,
2 which I understand very perfectly, other utilities can
3 wheel over.

4 VICE CHAIRMAN BUTTREY: And you're
5 regulated by the Public Utilities Commission in your
6 state?

7 MR. DiMICHAEL: Yes. In our states.

8 VICE CHAIRMAN BUTTREY: In your states.

9 And presumably you have differential
10 pricing arrangements with your customers? You charge
11 residential users different from you charge small
12 commercial and large commercial and mega commercial
13 interests?

14 MR. DiMICHAEL: May I, since the internal
15 counsel of Otter Tail is here, perhaps I might ask him
16 to answer that.

17 VICE CHAIRMAN BUTTREY: Yes. I'm just
18 curious.

19 MR. KOECK: Primarily we are primarily a
20 residential and small business provider of power. As
21 a result, we are tariffed or in one state we have a
22 performance-based rate making. So our customers are
23 pretty much in a captive state-based rate environment.

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1 There are a couple of exceptions with a couple of our
2 large industrial customers in which we are allowed to
3 contract. But those contracts themselves are also
4 approved by our public utility commissions in our
5 operating states.

6 VICE CHAIRMAN BUTTREY: Thank you.

7 COMMISSIONER MULVEY: The economist here.
8 Just a little clarification, and that is that
9 productivity is just simply output per unit of input.
10 And railroads are famous for having many, many, many
11 productivity measures; output per train mile, output
12 per track mile, output per car mile, for employee,
13 etc.

14 Certain factors in the railroad industry
15 is that tremendous improvements in productivity and I
16 believe, unless I'm mistaken, has lead all industries
17 in productivity improvements over the last 20 years.
18 That would be unlikely to be expected to continue, I
19 would think, that you would stay on top all that long.
20 A lot of the low hanging fruit, if you like, have been
21 taken especially with regard to employees. The
22 railroad workforce is a small fraction of what it was
23 20 years ago, and so the output per employee has gone

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1 up simply because the employee workforce has been
2 reduced so much.

3 And, yes, you're right that the crews
4 could be possibly be reduced from a two-man crew to a
5 one-man crew. But, again, that's probably going to be
6 difficult to achieve and will only be achieved through
7 negotiations.

8 And I'd also point out that in fact a lot
9 of these benefits, these productivity increases that
10 the railroads got, a lot of research suggests that the
11 railroads paid dearly for them. They weren't gotten
12 freely. They were expensive and they were negotiated.

13 It's also true, as Roger points out, that
14 capacity is at an all time high and that -- value,
15 rather, is at an all time high and capacity is very
16 much being strained. And therefore, it's unlikely
17 that some of these projected forecasts in traffic
18 system wide in the railroads won't be achievable,
19 simply because the capacity is not there.

20 So, again, there's limits for productivity
21 growth in that area, and that also concerns me.

22 And then finally, as I pointed out, I am
23 concerned about the achieveability of these things as

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1 many of them are great ideas but whether they're
2 actually going to be achievable in the near term, and
3 the near term being your term of 2008, I'm somewhat
4 skeptical of that.

5 MR. DiMICHAEL: Let me respond to at least
6 a couple of those things. It is true, certainly, that
7 the railroad industry if you look over the past, let's
8 say, 25 years since Staggers the number workers in the
9 railroad industry has declined significantly. But if
10 you look, for example, over the past four years which
11 is the relevant time frame from the RCAF-A, the drop
12 in railroad employment has not taken place. In fact,
13 there has been a slight uptick in railroad employment
14 over that time.

15 So, you know, yes if we were looking at
16 productivity trend going from 1980 to 2000, we can
17 certainly say surely there was a huge drop in the
18 number of people. But if we're looking over the past
19 three, four, five years on the people side, we
20 certainly can't say that.

21 And I think that -- well, maybe it's just
22 something I don't --

23 COMMISSIONER MULVEY: I was going to say

1 well what about the reduction in the size of the car
2 fleet? The railroads more and more now are having
3 shippers supply the cars, therefore their car fleet
4 goes down. Does that get measured in the RCAF-A that
5 they have greater productivity per car that they own
6 but they're now leasing more cars, so is that
7 captured? I could ask some of our economists about
8 whether that's separated out or not.

9 MR. DiMICHAEL: I guess I don't know
10 specifically about how it's calculated in the RCAF-A.
11 But if you look in this particular record here because
12 now the Otter Tail railroad is a coal railroad, it is
13 getting most of the cars that it has are, like BNSF
14 now has, are shipper supplied cars.

15 COMMISSIONER MULVEY: Right.

16 MR. DiMICHAEL: So as, for example, a
17 shipper which has brought a car, let's say, 15 years
18 ago on the BN and is now thinking of buying a new car,
19 heavy loading car, aluminum car, etcetera, the Otter
20 Tail railroad would get that exact same productivity
21 gain that the BNSF would get.

22 COMMISSIONER MULVEY: Thank you.

23 CHAIRMAN NOBER: Okay. Well, I just have

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1 one more set of questions, and that's about the PPL
2 test which I know there's been a lot of discussion
3 about.

4 And let me just make sure I understand.
5 You all just disagree with the test as a fundamental
6 concept, is that correct?

7 MR. DiMICHAEL: Yes, we do.

8 CHAIRMAN NOBER: And --

9 MR. DiMICHAEL: But as I said, we --

10 CHAIRMAN NOBER: Why is that?

11 MR. DiMICHAEL: Well, there's probably two
12 or three reasons. And I said, this is in a sense kind
13 of a mute point because we think we passed the PPL
14 test as the Board has done it. But there's perhaps
15 two or three reasons here.

16 One, we think that it is proper, actually,
17 to do a cross subsidy analysis. But we think it is
18 not proper to do a cross subsidy analysis on a
19 segment-by-segment basis. We don't think it is
20 actually possible because there are fixed costs as
21 well as variable costs. We think you can do it on a
22 traffic basis but not on a segment basis.

23 CHAIRMAN NOBER: I'm not sure I understand

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1 what you mean.

2 MR. DiMICHAEL: Well for example, you can
3 calculate whether a particular movement is covering
4 its variable costs or not, because there are variable
5 costs that are attributed to that particular move.
6 Okay. But there are fixed costs.

7 And when the Board calculates whether a
8 real railroad is cost subsidizing or not, it does not
9 look at it on a segment basis. It looks at it on a
10 traffic basis. In other words, is the railroad serving
11 this shipper in this movement, is it covering its
12 directly variable costs? It does not look at a
13 segment-by-segment basis. It looks at it on a traffic
14 basis, on a variable cost basis on the traffic itself.

15 Now, what the Board has done in this case,
16 what the Board has done in the PPL case is to mix --
17 is to try to identify to a particular segment of line
18 both fixed and variable costs and use those in
19 calculating the PPL test. But we think that that's
20 not really possible to do.

21 For example, there are variabilities in
22 all of the railroad costing. For example, station
23 clerical costs are about 70 percent variable and about

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1 30 percent fixed. Fuel costs are 90 percent variable
2 and about 10 percent fixed. Lots and lots of costs in
3 the railroad. If you get rid of the traffic, you would
4 still keep a certain portion of those costs. But what
5 the methodology that the Board has used in the PPL
6 test is to try identify to a segment of the line not
7 only fixed -- to the not only variable, but also fixed
8 costs because it's trying to geographically center
9 those costs. And we think that that's just not
10 possible to do because the fact of the matter is if
11 the traffic would go, it would -- the fixed costs --
12 the variable costs would go but the fixed costs would
13 remain. Because for example if the traffic would go,
14 for example, 70 percent of the station clerical costs
15 would disappear but 30 percent of the station clerical
16 costs the Board has calculated are not variable. They
17 would remain fixed. They are not segmented
18 geographically, they would rather just remain with the
19 railroad.

20 Finally, we think that PPL test is
21 inconsistent with the Board's own calculations of what
22 the proper test of cost subsidy is. The Board has
23 said the proper test of cost subsidy is a directly

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1 variable cost. We think that a SARR should be
2 measured by the -- a SARR steps into the shoes of a
3 railroad. It is a replacement for that railroad. It
4 should be measured by the exact same tests that a real
5 railroad is measured by.

6 CHAIRMAN NOBER: But isn't that the whole
7 basis of the SAC test, which is the traffic going at
8 least to that shipper is self-supporting and if it's
9 not enough to justify building out to the shipper
10 itself, then how can it be cross subsidizing any other
11 traffic? I mean, I don't understand it on the test,
12 but that's how I understand it.

13 MR. DiMICHAEL: Okay. But you cannot
14 identify to a particular segment of line the fixed
15 costs on that particular segment of line. Because if
16 the traffic does not go --

17 CHAIRMAN NOBER: You're saying there would
18 always be some residual fixed cost even if you dropped
19 that?

20 MR. DiMICHAEL: There will also be some.
21 But the Board is attempting to geographically identify
22 to a segment of line some of those fixed costs.

23 Let me maybe put it into a practical

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1 context here. When the BNSF and the UP, for example.
2 When the UP built in to the Powder River Basin, what
3 it was attempting to do in that case is to price when
4 it started to build in not its variable and fixed
5 costs, it was attempting to price on a variable cost
6 basis. And it could get or pay more than the variable
7 cost for that particular move, that was terrific.
8 Because now it was covering a little bit more than
9 other fixed costs.

10 CHAIRMAN NOBER: But it was also trying to
11 build a market?

12 MR. DiMICHAEL: Excuse me.

13 CHAIRMAN NOBER: There were other things
14 going on there.

15 MR. DiMICHAEL: But in other words it
16 decided to build if it could cover its variable costs,
17 thinking that over time it will gradual fill and up.
18 But I can tell you that for a long, long time, and the
19 Board well knows this, the pricing for competitive
20 rail movements out of the Powder River Basin was very,
21 very competitive which meant it was covering just
22 variable costs.

23 UP decided to build in not -- and UP was

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1 pricing to its customers on a variable plus fixed cost
2 basis, it was pricing to its customers basically on a
3 long run variable cost --

4 CHAIRMAN NOBER: But all of that -- I
5 mean, that may be in the real practical world of
6 negotiating a contract. But when we look at it as a
7 rate reasonable, this is how we apply it and we say is
8 it improperly cross subsidizing other traffic.

9 MR. DiMICHAEL: But what --

10 CHAIRMAN NOBER: So applying the PPL test
11 itself, I mean you may have quibbles with how we
12 measures what's the actual fixed costs of it, but it
13 seems to be reasonable approach particularly in a case
14 like this where such a large percent of the traffic
15 basically goes in a totally different direction than
16 Otter Tail's.

17 MR. DiMICHAEL: My only point was that
18 when a real railroad was attempting to decide -- let
19 me back up.

20 What the PPL test is attempting to do is
21 to determine whether a SARR would build the east/west
22 line. Okay. Would I build the east/west line or not.

23 When a real railroad was faced with that

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1 question in, for example, the Powder River Basin it
2 was answering that question on the basis of basically
3 long run incremental costs without regard to fixed
4 costs.

5 The Board should be looking at the same
6 question, the question is before the Board in the
7 exact same way and the Board should be answering the
8 question in the same way that a real railroad would.

9 CHAIRMAN NOBER: But to go to the original
10 question I was going to ask, which is the BN's point
11 on the sort of second PPL test, if you will, is simply
12 saying you shouldn't reduce the rate below the level
13 at which they are cross subsidizing other traffic. So
14 if you find that they are cross subsidizing other
15 traffic, let's just assume for the moment you say they
16 are, don't then by just a little bit but then the rate
17 reduction results in a reduction that would take you
18 below the cross subsidy points. That is no longer
19 cross subsidizing traffic. Don't reduce the rate
20 below there. That's their, as I think as I understand
21 their argument?

22 MR. DiMICHAEL: No.

23 CHAIRMAN NOBER: That's not their

1 argument?

2 MR. DiMICHAEL: Well, it is their
3 argument, but --

4 CHAIRMAN NOBER: And I was going to ask
5 you why is that not their point?

6 MR. DiMICHAEL: Okay. But what BN is
7 saying is that you should reduce the revenue not just
8 to the issue traffic, you should reduce the rate to
9 every single --

10 CHAIRMAN NOBER: But that's how our
11 percentage rate reduction assumes it.

12 MR. DiMICHAEL: But --

13 CHAIRMAN NOBER: It doesn't legally impose
14 it upon them, but --

15 MR. DiMICHAEL: Exactly.

16 CHAIRMAN NOBER: -- when we give you
17 relief, we do it by assuming everybody gets a
18 proportionate rate relief, right?

19 MR. DiMICHAEL: But that is a contrary to
20 fact presumption. You don't, as a matter of fact --

21 CHAIRMAN NOBER: Well, a lot of this case
22 is.

23 MR. DiMICHAEL: You don't as a matter of

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1 fact do that. The only rate reduction that is in fact
2 taken is one.

3 CHAIRMAN NOBER: That's the only rate
4 reduction which we legally impose rate reduction. But
5 our model assumes every -- you know, when we figure
6 out your rate reduction, right, we assume across the
7 board percentage rate reduction which I know people
8 have their beef with.

9 MR. DiMICHAEL: You calculate -- I will
10 not even go that.

11 CHAIRMAN NOBER: Okay.

12 MR. DiMICHAEL: You calculate the
13 percentage reduction on the basis of the total SARR
14 revenue. But you apply the rate reduction not to
15 everyone, you apply the rate reduction to a single
16 shipper.

17 CHAIRMAN NOBER: Okay. Any further
18 questions?

19 Thank you.

20 COMMISSIONER MULVEY: And not to
21 everybody, just to a single shipper? That's the only
22 one we apply it to?

23 MR. DiMICHAEL: That's right.

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1 COMMISSIONER MULVEY: For further
2 clarification, you were talking about fixed costs and
3 you said that if there was no traffic, there would be
4 still be fixed costs? If there's no traffic, there's
5 no fixed costs. That's the avoidable cost rather than
6 the fixed costs.

7 MR. DiMICHAEL: Right.

8 COMMISSIONER MULVEY: That's the overhead
9 costs that you would have for other parts of the
10 operation.

11 MR. DiMICHAEL: Yes. I misspoke. I didn't
12 mean if there was no traffic at all, but if that
13 particular would disappear.

14 COMMISSIONER MULVEY: Okay. Thank you.

15 CHAIRMAN NOBER: All right. Well, again,
16 we've kept you for a while but, Mr. DiMichael, thank
17 you for your arguments.

18 MR. DiMICHAEL: Thank you.

19 CHAIRMAN NOBER: And I know you've
20 reserved your little bit of time.

21 Mr. Weicher, welcome back.

22 MR. WEICHER: Thank you. Good afternoon.

23 I am Richard Weicher from BNSF.

1 With me is Sam Sipe, who after I take
2 hopefully ten minutes or so will then go on with the
3 remainder of our time.

4 Also with us is Jeff Moreland, the Chief
5 Legal Officer of BNSF. This is an important case to
6 us, as are all our coal rate cases.

7 I will cover some parts of the argument
8 and try to address a few of these railroad questions
9 that came up the last part of the argument. There's a
10 lot here, so Sam Sipe is very much anxious to get in
11 a number of the complex calculatory issues we've been
12 talking about as well.

13 We started with the premise that the
14 Board's function here is to protect a shipper from the
15 potential abuse of market power. We don't believe
16 there is any abuse of market power here or anything
17 that requires Board intervention. We don't believe
18 Otter Tail has been injured by pricing to its Big
19 Stone plant. It is correct that the expiration of a
20 multi-year, a decade long contract which we won't go
21 into details of but at the end of 2001 our company did
22 indeed offer a rate reduction for an extended contract
23 period. Otter Tail chose instead to not enter into a

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1 contract and seek a common carrier rate. The company
2 did publish a slightly higher rate in that event
3 without the protection or the attributes that come
4 with a contract, but there is nothing egregious or
5 outrageous going on here. And after a decade with the
6 contract, it is our understanding from public
7 announcements that Otter Tail is prepared to expand
8 and build an additional generating facility in the
9 climate they have been in.

10 It is also our understanding and is in the
11 record to expert study we put in, that it is true the
12 cost of delivered coal for Big Stone has gone up.
13 Almost entirely due to the increase in the unregulated
14 cost of coal, only a little bit due to the increase in
15 a regulated rail rate.

16 Nor is there evidence that the coal rates
17 in this case, the coal transportation rates, have
18 impacted the dispatch or the capabilities of this
19 power plant or kept it from producing in any respect,
20 or limited its production.

21 There is an elastic demand here. This is
22 a situation where differential pricing is in play, and
23 that is entirely correct and appropriate.

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1 It is also true that BNSF needs over the
2 long term to have adequate revenues to earn its cost
3 of capital. And it's critically important from our
4 standpoint in this or any coal case, that the Board
5 not retreat into some cost-based allocation ignoring
6 the broader purposes of regulation, the broader
7 purposes of the Act and our need as well to generate
8 revenues for massive investment. This is not the
9 place to just retreat into formulas and arcana, not
10 that that isn't a big part of any of these case. But
11 investment doesn't come out of thin air. It comes out
12 of real dollars for an expensive structure. It's not
13 a time for arbitrary rate caps based on formulas.

14 Now, I have been involved in the stand
15 alone cost cases since the beginning and since the
16 formulation of constrained market pricing. I think I
17 used to think I knew what this thing was supposed to
18 do or when it started out, it was supposed to have a
19 purpose, I believe, to create the theoretical
20 alternative for a shipper so that it wouldn't pay more
21 than it had to build and operate its own railroad.
22 That was the theory, we believe, of constrained market
23 pricing of the stand alone railroad. That original

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1 premise was to say what's the alternative, what's the
2 economic alternative as part of Ramsey pricing for in-
3 elastic demand. If it was elastic demand in a totally
4 competitive situation, and there had been a built-in,
5 we wouldn't be having this delightful discussion of
6 all this arcana. But it is a place with in-elastic
7 demand, so it is appropriate to look at that
8 alternative. But that alternative, and I believe Mr.
9 DiMichael used the term the SARR should be measured by
10 the same test as a real railroad. Well, that's true.
11 We've gotten so far from that such thing it's
12 ridiculous. You have a separate discussion of issues
13 under SAC in general, but within this case we have the
14 same kind of issues of massive crossover traffic,
15 multiplied by the issue of whether there are even any
16 common facilities between the issue traffic, the Otter
17 Tail traffic, and all this crossover traffic.

18 The crossover traffic in this case from a
19 layman's standpoint, I'll put that as a layman from
20 the economist standpoint. I am a lawyer, but this is
21 now we're into the economic theory of Ramsey pricing
22 and constraint about the pricing. We're so far out on
23 the fringes now.

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1 We've got 95 percent plus crossover
2 traffic driving this railroad not as a method of
3 simplification, but as a way to put in a toll or slice
4 a nickel or slice or a something off gazillions of
5 tons of coal that have nothing to do with real world
6 Otter Tail alternative. And we got all this coal
7 going out the south end, we distribute it. And I know
8 Mr. Sipe will use this also, but there's a map in the
9 packet which is very similar to complainant's map,
10 that shows their stand alone railroad and shows
11 Cordero and Donkey Creek, the south end of the Powder
12 River Basin.

13 A 100 plus million tons of coal are coming
14 south out of the basin from a point beyond where Otter
15 Tail goes north. And I get mixed up on this every
16 time I get through it. But in order to create --
17 there is some double crossover or crossover on
18 crossover or something that goes out the north that
19 happens to touch some of the track that goes out the
20 south so they can pull in 150 tons going south and
21 then take the issue that I know is very important, you
22 know, dollar versus mileage allocation and take a
23 division. But before you get to that division and all

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1 that issue, you have to look at why is all this
2 traffic in this stand alone railroad. Where is it
3 coming from? You know, it's just popping in there we
4 think -- I think far beyond any rational application
5 of stand alone railroad theory as it started out.

6 This kind of ties in -- well, it does tie
7 into the PPL test, which I'm sure Mr. Sipe will
8 address in greater detail. We agree with the PPL
9 test. If anything, it doesn't go far enough. But
10 beyond the PPL test here, you've got they're trying to
11 pull in all this traffic to support an PPL test or to
12 pass a PPL test.

13 Another critical issue we need to address
14 from the real railroad standpoint, a SAC railroad must
15 reflect the real costs of infrastructure and physical
16 plant. This is an issue in all of these cases, it's
17 an issue here, too. It isn't, other than the
18 productivity and indexes ones, it hasn't been of the
19 marquee you've talked about -- or excuse me, the
20 complainant raised in his argument. But we have
21 another situation where we have from a railroad
22 standpoint, a real railroad standpoint low ball
23 estimates of earthwork, minimum grading, skip a bunch

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1 of the access roads along the stand alone railroad to
2 service it and then out source the maintenance to the
3 low cost most theoretically more efficient plant.

4 The chart that complainant used to compare
5 to average out of R1 maintenance of way figures for
6 our entire 33,000 mile plus system, not the Powder
7 River Basin; not what's happening in the real world
8 with coal.

9 And, Commissioner Mulvey, you know, I have
10 looked at the records here. These are such used
11 records, I can only say to the best of my knowledge it
12 doesn't cover fugitive coal dust or the coal dust
13 issue. I believe that the maintenance costs here
14 certainly in Otter Tail's SAC railroad are way
15 understated. They are probably understated for our
16 real world experience in keeping an enormously complex
17 plant like the Powder River Basin in place.

18 And as to the productivity issue, again
19 and we had the opportunity to try to checkout while
20 you were asking complainant, I don't know the answer
21 to the forward looking productivity so much as we know
22 there were great productivity increases in the past,
23 a lot of them in the late '90s through the merger era.

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1 Certainly we as a company plan for, expect and
2 continue to seek productivity increases in the future.
3 Whether they can keep pace with what has happened, I
4 don't know. And they always involve trade-offs,
5 whether it's capital for the bigger locomotive or
6 capital for the PTC or the systems to automate a
7 railroad in addition, of course, in negotiation with
8 labor over what that does to employees and what they
9 must be paid over time. And as that happened in the
10 past when those changes occur, they occur in our
11 industry through that whole process, and it is not an
12 automatic -- it can't be, or an expensive process, nor
13 should it be when those rights must be respected.

14 Though the system of a SAC railroad being
15 propounded in our view should not be a SAC like
16 cheapest alternative through the system, that's not
17 feasible under the standards of constrained market
18 pricing. That's not the standard that approaches real
19 world.

20 It's a hot summer day in the District of
21 Columbia and in the midwest, and in the southeast and
22 the southwest. We have 100 utilities my company is
23 handling coal to out of the Powder River Basin. We

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1 are under tremendous stress in doing that. We are in
2 a situation right now in Powder River Basin, we're in
3 a 24/7 situation with maintenance being pulled from
4 everywhere, massive pieces of equipment all to
5 maintain the fluidity, deliver the coal and expand the
6 infrastructure to maintain service for the user
7 utility. This is a big dollar, major enterprise.

8 Our Chairman said yesterday to the world
9 that we're up to this commitment to our customers. WE
10 will meet it. We will continue to invest. If the
11 Board wants to tell us that that's an improvement and
12 that with these rates we're going to be regulated on
13 a cheap basis, a minimal basis, a no reliability
14 basis, a basis that doesn't have that capital, that's
15 what happens if you just pick through and take the
16 lowest number of every 50 columns, try and peel it
17 down, ignore the need for capital and use artificial
18 numbers other than the real world.

19 I think that was the ten minutes. I could
20 go on, but Mr. Sipe has to cover several of the other
21 critical issues.

22 We have to respond to questions, however
23 you do it later.

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1 CHAIRMAN NOBER: Mr. Sipe?

2 MR. SIPE: Thank you, Chairman Nober.

3 Good afternoon, Vice Chairman Buttrey,
4 Commission Mulvey.

5 I think this might be my third or fourth
6 time doing one of these arguments, and I was just
7 sitting there asking myself am I maybe getting a
8 little tired of this. And the answer is this
9 afternoon has gone on for a while, but the overall
10 argument I'm not tired of. I think this has been a
11 really good discussion so far. I think Mr. DiMichael
12 focused on the real issues in this case. I don't
13 happen to agree with very much of what he said, but I
14 think he focused on the real issues.

15 I think the Board members' questions
16 focused on the real issues. And I'm going to try to be
17 responsive to those issues.

18 Can you hear me okay, because I'm not too
19 close to the mike.

20 CHAIRMAN NOBER: Yes. You're taller than
21 the average litigant, I guess.

22 MR. SIPE: I could take my shoes off, but
23 that would be a little too folksy.

1 Let me start with the revenue issues
2 because I think they are, from our perspective, the
3 controlling issues in the case although not the only
4 issues. And I'll start with a point that was important
5 Mr. DiMichael, which is the so-called market-based
6 divisions. Their preferred case is built on these
7 extrapolations of so-called real world divisions,
8 information that they obtained from us in discovery.

9 First of all, I would say that the way I
10 read the Board's precedent on crossover revenue
11 allocation the Board has not definitively adopted a
12 single preferred method for allocating revenue on
13 crossover traffic. The two prior cases that had been
14 decided prior to the submission of opening evidence,
15 I believe TMPA and PPL both indicated that there was
16 not at that point a single preferred methodology. I
17 don't think it's a fair reading of the Board's
18 precedent to say that there is a commitment to market-
19 based divisions.

20 This is very important in my mind. I
21 don't think there has been a serious effort on the
22 part of any of the shippers who have espoused so-
23 called market-based divisions to talk through in a

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1 coherent economic framework how a real world
2 defendant's divisions on traffic with other real world
3 railroads reflects a paradigm that could be meaningful
4 in the hypothetical context of crossover traffic.
5 Because the reality is there are no divisions on
6 crossover movements. There are no such movements.
7 There are no negotiations in a contestable market
8 where an entry is completely free and exit is
9 completely free to tell us exactly how those revenues
10 would be determined. And I think in the absence of a
11 coherent framework it would be extremely perilous for
12 the Board to go back to market-based divisions or some
13 semblance of them. And I think what you said in the
14 Duke NS case is that you didn't want to go that way.

15 I think what you said in Duke NS is that
16 you felt that a cost-based approach to crossover
17 divisions was a more reliable framework. The language
18 specifically was the revenue allocation should reflect
19 to the extent practicable the defendant carrier's
20 relative costs of providing service over the two
21 segments. And our economic witness in this case,
22 Professor Ordover, although he obviously criticized
23 the concept of crossover traffic, did state that a

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1 cost-based revenue allocation procedure would be
2 superior to a supposed market-based approach because
3 " a cost-based revenue allocation is a proxy for the
4 comparison of revenue and cost that is the essence of
5 the SAC test." At least you're taking into account of
6 what you have to pay to carry the traffic over the two
7 segments of the crossover movement.

8 Now when we filed our opening evidence in
9 this case we were espousing the density adjusted
10 method, which has subsequently been rejected by the
11 Board. And we don't agree with that and we think if
12 you went back and looked carefully at what we said and
13 thought about it in context, you might conclude that
14 it is the best approach. But I don't think it would
15 be wise for me to butt my head against that wall, and
16 I hope Mr. Atkins doesn't quote me on it in his next
17 brief. But I said it with full knowledge.

18 So what we are advocating here is a cost-
19 base revenue allocation procedure that we think
20 satisfies --

21 CHAIRMAN NOBER: He quoted me in that
22 brief, too.

23 MR. SIPE: We both got in there a couple

1 of times, at least once on the same subject.

2 We have presented evidence as a cost-base
3 revenue allocation in this case which we think
4 achieves or best achieves, given the record in this
5 case, the Board's objective of establishing a fair
6 cost-based division between the shippers. The issue
7 here has to do with the origin credit that you assign
8 as part of the MSP methodology that the Board adopted
9 as its default methodology in the Duke Norfolk
10 Southern case. And I think I can put this in context
11 for you by referring you to a couple of the
12 attachments that we handed out.

13 First of all, there is the map which was
14 part of our evidence in an earlier submission which
15 shows the Otter Tail stand alone route of movement.
16 And we highlight in there a portion of the short haul
17 traffic that exits the Powder River Basin to the
18 south. And the only point I want to make right now is
19 that there is a huge volume of traffic that Otter Tail
20 used in its design of the stand alone railroad here
21 that is very short haul crossover traffic; 25 miles or
22 less.

23 If you turn to the next page, you'll see

1 that there are basically two large segments of that
2 short haul crossover traffic. And we're talking now
3 about under their alternative case where they use the
4 MSP revenue allocation with the 100 mile block.

5 There are 84.5 million tons of traffic
6 that travel south from Cordero. This traffic averages
7 only 24 miles on a 1200 mile railroad. One-third of it
8 averages 8 miles or less on the Otter Tail. On and on
9 the bottom line here is that the Otter Tail's share of
10 revenue on this southbound traffic is almost five
11 times larger than the residual BNSF's. Same thing for
12 the traffic that goes south and exits the stand alone
13 railroad at Donkey Creek.

14 What we think is going on in this case is
15 that Otter Tail deliberately designed a stand alone
16 railroad that tries to take advantage of large amounts
17 of revenue generated by the short haul crossover
18 traffic. And the vehicle for getting the revenue here
19 is the 100 mile origin credit.

20 You'll see in the handout here that a very
21 substantial portion of the revenue is attributable to
22 the origin credit. On the Donkey Creek traffic, for
23 example, 87 percent of revenue is attributable solely

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1 to the 100 mile origin credit.

2 We took a careful look at the costs
3 implicit in that 100 mile origin credit. It's a
4 system average number. As Mr. DiMichael said, it's
5 drawn from the carload Waybill Sample. But we know
6 that unit train originations are far more efficient
7 than originations of single carloads which often have
8 to be switched in and out of trains. And the Board's
9 own adjustments to URCs suggests that they are about
10 25 percent of the system average carload origin cost.

11 Now Mr. DiMichael suggested a number of
12 reasons why the Board shouldn't pay any attention to
13 our evidence on the revenue allocation, the 25 mile
14 block. First of all, he said it's inconsistent with
15 precedent, and I really think that was also kind of
16 the gist of his last point where you quoted from the
17 brief. But the fact is the Board has said it's looking
18 for the most accurate reflection of the costs. And if
19 it's undisputed that the 100 mile credit overstates
20 the cost of originating coal traffic, then the Board
21 ought to go with something that's more accurate.

22 And we put in detailed information on that
23 in the context of our evidence. And I'm not going to

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1 read from it here, but I'd like to refer the Board
2 specifically to our supplemental reply evidence, dated
3 March 22, 2004, Exhibit 3A9 where we explain in detail
4 why the 25 mile origin credit for coal originations in
5 shipper owned cars is the most appropriate evidence of
6 record.

7 Mr. DiMichael also says that we ignored
8 line haul costs. But if you read that exhibit
9 carefully, you'll see that we didn't.

10 He also says that somehow if you were to
11 adopt the 25 mile credit, in this case you'd be
12 jeopardizing the Board's carload Waybill Sample. But
13 we're not talking about using the 25 mile credit for
14 purposes of the carload Waybill Sample. We're talking
15 about using it as a revenue allocation in a SAC case.
16 And the Board can surely do that without jeopardizing
17 what it does with its carload Waybill Sample.

18 In short, on this issue which it's really
19 a very big issue in the case, if you were going to
20 take seriously what you said about trying to find a
21 revenue allocation procedure that fairly divides the
22 costs between -- that covers the costs of the two
23 portions of the stand alone movement, I think you

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1 really on this record have to go with the 25 mile
2 block.

3 I think it's instructive also for the
4 Board to remember that when it departed modestly from
5 MMP in the Duke NS case, its motive for doing so was
6 to avoid an incentive for designing a SARR that was
7 perhaps designed to take advantage of the revenue
8 allocation procedure.

9 You'll recall that in that Duke NS case
10 the Board adopted MSP with the 100 mile origin and
11 termination credits and it chose to do so because of
12 its concern that the modified milage prorate, the
13 block methodology as the Board called it there, "leads
14 the parties to design SARRs to take advantage of its
15 revenue allocation rather than produce the fairest
16 division between the carriers." And I think it's
17 pretty clear from the data that we've presented about
18 these short haul movements that that's exactly what's
19 going on here. If you use something that more closely
20 approximate costs, you are going to have a fairer
21 result. And you're not going to have stand alone
22 railroads designed in the future solely to take
23 advantage of short haul movements.

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1 Now I want to talk a little bit about the
2 PPL test. We think that the PPL test is correctly
3 decided, correctly implemented by the Board. And we
4 also think that there should be a second step to the
5 PPL test, which is to apply it at the rate
6 prescription stage. And if you stop and think about
7 it if you were to adopt that approach, you wouldn't
8 really be asking the Board to go through a full
9 fledged application of the PPL test twice. Because
10 when the parties submit their opening evidence, the
11 nature of the submissions in these cases is the
12 shipper is always going to pass the PPL test based on
13 its evidence because it has claimed vast revenues and
14 very low costs. I mean, that's just the nature of the
15 beast. We all know that.

16 Similarly, the railroad is always going to
17 show that the shipper flunks the PPL test based on its
18 opening evidence because the railroad always says the
19 revenues are a lot lower and the costs are a lot
20 higher. So, in fact, you don't need to do it after the
21 parties file their first two rounds of evidence. It's
22 only after you've decided what the revenues and the
23 costs are that application of the PPL test is

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1 meaningful. And at that point you're either going to
2 know whether a rate reduction is called for or whether
3 a rate reduction is not called for.

4 If a rate reduction is called for, then
5 you take a look at the PPL test in the context of the
6 rate prescription.

7 In the final pages of the handout that I
8 gave you this afternoon we produced three schematics
9 from the evidence we put in on March 1st of this year
10 where we show what happens when you apply the PPL test
11 at the rate reduction stage. It's quite
12 straightforward. You basically have a SARR with two
13 segments, an east/west segment and a north/south
14 segment. In our example, the first page 3A5 you've got
15 an overage on both segments of revenues in excess of
16 costs. But the overage on the short north/south
17 segment is proportionately greatly than on the
18 east/west segment.

19 On the second page it shows that when you
20 add that those two overages together for purposes of
21 computing a system-wide rate reduction, you find the
22 total overage in our hypothetical example of 15
23 percent \$300 out of \$2,000. And that would imply

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1 under the Board's percentage rate reduction approach
2 a 15 percent across the board rate reduction.

3 And what the third page shows is when you
4 do that, you end up with a reduced rate for the
5 traffic on the east/west segment of \$1445 versus
6 collectively attributable costs of \$1500.

7 And the point here, which I think came out
8 in Chairman Nober's questioning, is that the traffic
9 on the east/west segment is not covering its
10 collectively attributable costs. And the essence of
11 the SAC test is this: At what rate level would a
12 hypothetical stand alone railroad enter the market to
13 serve the issue traffic and other traffic grouped with
14 the issue traffic? Would a hypothetical stand alone
15 railroad build this east/west segment at all if it
16 knew it was going to receive \$55 less than its full
17 economic costs? And the answer is pretty clear. It
18 wouldn't.

19 We think the logic of the test at the rate
20 reduction stage is pretty much infallible, and if
21 there's any question on the Board's mind with respect
22 to that, I would certainly be happy to get into it.

23 So those are the big, if you will, revenue

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1 issues in this case that we believe drive the result.

2 Let me just say there's a related issue
3 that I want to allude to because Mr. DiMichael
4 mentioned it, and that is the south of Cordero
5 traffic, which we have argued in this case should be
6 excluded.

7 I agree with Mr. DiMichael's
8 characterization that if you apply the PPL test
9 properly, and in our mind that would mean applying the
10 PPL test with the revenue allocation based on MSP with
11 25 mile origination credits; if you apply it properly
12 here, then the southbound traffic problem is really
13 taken care of. The reason we argued in this case that
14 the southbound traffic should be excluded is that we
15 thought it was so clearly an attempt, to use a word
16 that has been overused and we've probably overused it
17 among others, to gain the configuration of the stand
18 alone system. And we thought the best way to send a
19 message to shippers would be to exclude that traffic.
20 Because it doesn't share facilities with the issue
21 traffic. What is it doing in there?

22 We also think it is, in fact, to exclude
23 it would be consistent with the Board's simplification

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1 rationale that it is used to justify crossover traffic
2 in the first place. The Board says let's focus on the
3 issue traffic route of movement. Well, here we're
4 talking about something that's not part of the issue
5 traffic route of movement. It would be clear and easy
6 as a threshold matter to knock this traffic out of the
7 stand alone model, and we think the Board could do.
8 But I'm not saying that I think it's essential.
9 Because if you apply PPL properly, you should get to
10 the right result.

11 Now, let me mention a few of the other
12 matters that Mr. DiMichael addressed. And let me
13 preface it by saying that we have had so far in this
14 oral argument a good discussion of the issues, but no
15 discussion of the procedural posture of the case when
16 a lot of this evidence was put in. And this is
17 important for us, because on several of these issues
18 where they are claiming they now have the best
19 evidence of record, that evidence never came in as
20 part of their opening case and we never had an
21 opportunity to address it. We've had to file a major
22 motion to strike back in the spring of 2004 because
23 they came in with several categories of impermissible

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1 rebuttal evidence back then. And I'm just going to
2 refer you to the motion. I'm to going to, obviously,
3 read it again. But it cuts across a lot of these
4 issues.

5 And let's talk, first of all, about the
6 operating plan. Chairman Nober, you said at the
7 outset that Otter Tail has come in and submitted the
8 RTC model. And we have this seemingly anomalous
9 situation where BNSF has been advocating use of the
10 RTC model in case after case, but we didn't model the
11 entire stand alone system and somehow they fault us
12 for that. But how did that come to pass?

13 The way it came to pass in the procedure
14 of this case is that, as usual, they came in initially
15 with a string program. And the string program had a
16 lot of problems, and I think everybody here agrees
17 that it's seen its best days, if it had any good days
18 and now we're in the RTC world. But we weren't at the
19 beginning of this case.

20 So we have reply evidence. And we look at
21 their evidence and say we don't need to model the
22 entire system because we can tell that they have
23 sufficient capacity on two segments of the stand alone

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1 railroad. And what is the RTC model used for? It's
2 used for two things primarily. It's used to determine
3 whether there is sufficient capacity, and that goes to
4 the construction cost side of the equation. If
5 there's not sufficient capacity, you have to build
6 more. And it's used to determine transit times,
7 primarily online transit times.

8 Here's what we did. We took a look at two
9 of these four segments and we said capacity is
10 sufficient and we said we'll use our real world
11 transit times for those segments because what they
12 built modeled what was there in the real world.

13 As to the other two segments, we used the
14 RTC model.

15 So we went through several iterations of
16 the string program in this case. They kept
17 resubmitting it, it continued to have problems.
18 Finally the Board, as you know last December and
19 January of this year, said we're going to call for
20 submission of evidence on these modified traffic
21 groups. And the Board made clear we're going to let
22 Otter Tail come in at the end of the day and use the
23 RTC model.

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1 Well, that's fine. I'm not saying the
2 Board shouldn't have done that. But I'm saying that
3 was not their opening case. If they had put in a full
4 RTC model opening, of course we would have modeled the
5 full stand alone railroad. But things never unfolded
6 so as to give us the opportunity or incentive to do
7 that. And we accepted basically what they modeled in
8 the RTC.

9 They turn around and say BNSF's operating
10 plan is flawed because we only did a piece of it. But
11 under these circumstances it's clear why we only did
12 pieces of it. But under these circumstances it's
13 clear why we only did pieces of it.

14 Now what is really driving any differences
15 between the parties on the operating plan? It's
16 primarily two things related to the yards. It's dwell
17 time in the yards and it is yard capacity.

18 The RTC model does not tell you terminal
19 dwell time. Terminal dwell time is an assumption that
20 the parties put into the RTC model. They said two
21 hours, we said six hours. Our six hours is
22 consistent, I believe, with what you've decided in
23 prior cases and we think it's well defended in this

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1 case. But the answer should not be does the RTC model
2 spit out two hours or six hours or some other number
3 of hours. Because it's an assumption that is input
4 into the model, it's not an output.

5 As to yard capacity, think about it.
6 Dwell times means how many rail cars and locomotives
7 do you have sitting in a rail yard. Capacity is going
8 to be a direct function of dwell times. If they're
9 only in there for two hours, you're going to be able
10 to move them in and move them out and you won't need
11 so much yard track and other space in the yards. If
12 they're in there for six hours, you're going to use
13 more capacity. That's how we got the different dwell
14 times and yard capacity in this case, and we think the
15 record fully supports our assumptions.

16 Now, Mr. DiMichael said you couldn't run
17 the RTC model to completion -- I think he said this --
18 if you used our terminal dwell times. The answer to
19 that then is for the Board to go back, if it decides
20 our terminal dwell times are the right times, is for
21 the Board which now has the model to go back and run
22 it with the six hours and see if you need anymore
23 capacity on this stand alone railroad so that the

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1 model will run to completion. There's no reason you
2 can't do that. But we should not be faulted under the
3 facts of this case for not having modeled the entire
4 SARR.

5 Productivity. This is an issue where
6 impermissible rebuttal and the burden of proof clearly
7 comes into play. In their opening evidence Otter Tail
8 had one sentence and stated without any explanation or
9 supporting evidence that the annual inflation forecast
10 should be the RCAF-A.

11 We said they didn't put in a case. They
12 put in a naked assertion. We said the RCAF-U; that's
13 what you've used in all your prior cases for reasons
14 that are pretty well grounded.

15 Now I think everybody in this room
16 believes that a hypothetical stand alone railroad
17 might experience some modest productivity gains into
18 the future. I don't think it was our obligation to
19 say in response to their opening evidence what that
20 might have been based on this record. I don't think
21 there's anything in the record that tells you what
22 those modest productivity gains might be. They didn't
23 make any effort whatsoever to link their laundry list

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1 of possible productivity improvements to specific
2 productivity gains effecting different areas of stand
3 alone railroad operations. There's no basis,
4 unfortunately. I know the Board would like to do
5 something in these area, but there's no basis in the
6 record for the Board to make an informed intelligent
7 statement that we're going to use, let's just pick a
8 hypothetical number, ten percent of the RCAF-A and 90
9 percent of the RCAF-U going forward.

10 A similar issue with respect to debt
11 costs, similar in the sense of this is an issue that
12 first came up on rebuttal. It's not correct to say
13 that Otter Tail simply updated debt calculations.
14 What Otter Tail did was to modify the basic approach
15 that it used on opening, which was to use the industry
16 average cost of debt for the period 1999 through 2001.
17 On rebuttal, Otter Tail used the industry average only
18 through 2002 and then assumed, simply assumed that
19 OTRR will refinance the debt portion of its capital
20 structure in first quarter '03 at a much lower
21 interest rate. There's no justification or rationale
22 as to why this approach is justified.

23 It clearly wasn't responsive to BNSF's

1 reply evidence since BNSF accepted Otter Tail's
2 opening methodology. Otter Tail provided no evidence
3 that the SARR would be able to refinance a debt burden
4 of the size of the SARR's debt, no evidence about the
5 interest rates that might apply to such a refinancing,
6 and no evidence about the financing fees that would be
7 required if a financing were feasible.

8 And it's true, a lot of people have
9 probably refinanced their mortgages. But if there's
10 someone here who has done it without paying any fees,
11 maybe he or she could give me a call and refer me to
12 your mortgage banker so I could take advantage of that
13 deal, too.

14 But I think that there is an important
15 point here about the state of the record. The Board
16 laid down rules in one of the eastern cases about the
17 circumstances under which rebuttal would be
18 appropriate. And we think that in several of these
19 areas Otter Tail has not adhered to that.

20 It looks like I'm almost out of time.

21 On the maintenance of way issues, Mr.
22 DiMichael urged you to look carefully at the evidence.
23 I would simply urge you to do the same. We've

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1 approached maintenance of way from the bottom up,
2 haven't out sourced it. We've provided realistic
3 justified estimates of what it would actually cost to
4 maintain a high volume, high density coal hauling
5 railroad. And we think that as in the recent cases,
6 our evidence is the best evidence of record.

7 I'll stop there.

8 CHAIRMAN NOBER: All right. Thanks.

9 Commissioner Mulvey, you want to start?

10 COMMISSIONER MULVEY: First of all, with
11 regard to refinancing using 2003 rates do you know
12 what happened to railroads' cost of capital for 2003
13 and 2004?

14 MR. SIPE: I think the industry cost of
15 capital has been trending down somewhat over the last
16 few years.

17 COMMISSIONER MULVEY: Our most recent
18 calculation, however, show the cost of capital
19 increasing for 2004, largely due I believe to the cost
20 of equity capital, albeit the cost of debt financing
21 seem to be either flat or trending up.

22 I have a question. You didn't model the
23 entire system, but would it have been that expensive

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1 to have gone and modeled the entire system so we
2 wouldn't have this dispute between who modeled what
3 and whether or not there was comparability between the
4 two?

5 MR. SIPE: I think in the scheme of things
6 had we known that the issue was going to be here, we
7 would have certainly done the modeling. But the
8 circumstance we were facing was that they had put in
9 a model based on the string program. Our people who
10 know railroad operations looked at it and said it
11 looks like they have enough capacity on two of these
12 segments. Why don't we just go ahead and accept that
13 and avoid -- and this is ironic -- avoid a dispute as
14 to those and model the segments where we think there's
15 an issue. In hindsight one would say we should have
16 done it otherwise, but I think we had a good reason
17 for doing it the way we did it.

18 COMMISSIONER MULVEY: With regard to the
19 crossover traffic moving south, I realize that
20 relatively little of it operates over the SARR. But
21 hasn't the Board used crossover traffic in other cases
22 that didn't use the SARR at all or didn't use any of
23 the SARR's facilities and hasn't been in our

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1 precedent?

2 MR. SIPE: I think the Board did do that
3 in the CSX Duke case. And I read the discussion of the
4 issue a couple of times, and I'm not sure I understood
5 it. And here's my problem on this particular issue,
6 but it may be just a lack of understanding.

7 The guidelines talk about grouping traffic
8 so as to share joint and common costs between non-
9 issue traffic and the issue traffic. That's pretty
10 much a statement out of the guidelines. That's an
11 objective that we all recognize as a valid objective
12 and it's part of what makes SAC work.

13 Where you don't have traffic sharing the
14 same facilities, it seems pretty clear that the
15 sharing of costs, at best, become tenuous.

16 And then we have statements in a couple of
17 subsequent cases to the effect that a shipper should
18 not be asked to pay for facilities it doesn't use.

19 So we thought under the Board's precedent
20 it is more colorable to say that that traffic should
21 be excluded. But as I mentioned if a proper
22 application of the PPL subsidy test solves the
23 problem, then maybe it doesn't need to be a big issue

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1 here.

2 CHAIRMAN NOBER: Let me start with the
3 same issue I started with with Mr. DiMichael, which is
4 what is -- if we assume for the sake of argument that
5 the shipper puts in a feasible operating plan, what
6 amount of deference ought that to get?

7 Now, you all have objected very much to
8 the Board extrapolating operating plans in past case.
9 You have felt that that placed an unfair burden.
10 You've objected to being asked to model entire
11 railroads. I think you've made a point not to quote
12 briefs of having the Board make the railroad prove the
13 shipper's case for it.

14 Now here, just for the sake argument,
15 let's say we have an example where the shipper has put
16 in a feasible operating plan, which is what everyone
17 has wanted them to do. In that circumstance then how
18 much deference should we give even the assumptions
19 that go into it like yard and dwell time if we have
20 one?

21 MR. SIPE: Okay. Well, let me try to be
22 as specific as I can. And I will tell you, Chairman
23 Nober, that I don't view myself as necessarily the

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1 world's expert on these issues, but I am familiar with
2 them.

3 I would say that where the Board accepts
4 the shipper's operating plan, that means that the
5 shipper has proved its case regarding mainline
6 facilities; that is the amount of track capacity you
7 needed. It hasn't proved its case, obviously, as to
8 the unit costs of those facilities. But in terms of
9 miles of track it's proved its case. Basically how
10 much railroad infrastructure do you need.

11 CHAIRMAN NOBER: Okay. And would yard
12 capacity be a function of that?

13 MR. SIPE: No, yard capacity is not a
14 function of that. I tried to explain this and may not
15 have been sufficiently clear.

16 CHAIRMAN NOBER: No. You said you think
17 it's a function of dwell time.

18 MR. SIPE: I think yard capacity is
19 primarily a function of dwell time, and dwell time is
20 not an output of the string program. It's an input,
21 it's an assumption. Our witness on that in this case
22 is Mr. Loren Mueller, who is a former BNSF operating
23 officer who took a look at real world yards and knows

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1 what you have to do in yards.

2 And I could go down the different other
3 categories. I mean, transit times, line haul transit
4 times are a function of the operating plan. Line haul
5 transit times effect number of crews, so I think you
6 probably have a pretty good correlation there between
7 a valid shipper operating plan and the number of train
8 personnel you might need. But I'd better watch myself,
9 because there's some things buried in the details
10 there like assumptions that some guy's going to work
11 270 days a year. I don't think we necessarily agree
12 with that.

13 Locomotives, however, there are issues
14 other than the output of the operating plan that
15 effect the number of locomotives you need, which has
16 to do with how you calculate the peeking factor which
17 is an issue in this case.

18 So, you know, what I would say as a
19 generic matter is if I am you, Chairman Nober, saying
20 to my staff produce for me a decision that generates
21 the right results based on the fact that we're going
22 to accept the shipper's operating plan, what I'd say
23 is go and identify for me how closely each of these

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1 factors is determined by the output of the operating
2 plan, and you should be able to figure it out.

3 CHAIRMAN NOBER: Did you have a question?

4 VICE CHAIRMAN BUTTREY: On that same
5 point, we've visited several yards, several inspection
6 point on the different railroads. And the information
7 that we get when we do that, I believe, I'm accurate
8 in saying that the information we get is that coal
9 trains, the coal -- transportation of coal on rails
10 tears up more cars, more rail and requires more
11 inspections than anything else that the railroad does.
12 Now, I don't know whether anybody else would agree
13 with that or not, but that's the information that I
14 take away from these site visits that we do.

15 And I'm also under the impression, anyway,
16 that there are more inspections done at the beginning
17 of the trip as the coal moves out and the beginning of
18 the trip going back, so to speak, with the empties
19 than anywhere else along the line.

20 I mean, wouldn't have a significant effect
21 on these dwell times and the yard capacities and that
22 sort of thing?

23 MR. SIPE: I think clearly if you're doing

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1 more and more intense inspections, Vice Chairman
2 Buttrey, you're going to have longer dwell times.
3 Sure. Not to mention all the other things that go into
4 it like switching out bad order cars and so forth,
5 which happens a lot with coal trains.

6 MR. WEICHER: And if I may, Vice Chairman
7 Buttrey, that is also why, empirical observation is
8 why the data in one of the charts that the complainant
9 put up comparing system average maintenance of way
10 numbers out of the R1, spreading everything across
11 everything, is not an accurate portrayal for coal.
12 Our's is, as Mr. Sipe said, a ground up or from the
13 ground up build up of the true costs.

14 COMMISSIONER MULVEY: Otter Tail expressed
15 a purpose for its operations to develop the Fargo
16 area. I, too, have visited Fargo and am quite fond of
17 Fargo and its people. But I'd like to ask you, do you
18 have any data on what the delivered price of coal is
19 to the final consumer compared to the transportation?
20 What share of that is rail transportation costs?

21 MR. SIPE: It's in the record, and I think
22 I have a volume in a briefcase, I could look it for
23 you. But I can tell you where it is. In our reply

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1 evidence we sponsored it would be section 3A
2 somewhere. We sponsored testimony by an electric power
3 expert, Mr. Kenneth Slater who looked specifically at
4 delivered cost of power to Big Stone. And as Mr.
5 Weicher say, what Mr. Slater found is that the
6 delivered cost went up by a nontrivial amount between
7 the end of 2001 and 2002, which was when our rate
8 increase took effect. A vast preponderance of the
9 increase was attributable to an increase in the
10 unregulated price of coal.

11 You wouldn't have to be too paranoid to
12 think that maybe these folks are trying to make up for
13 whoever made that decision on the coal, by getting a
14 little money back from the railroads.

15 COMMISSIONER MULVEY: Mr. DiMichael
16 submitted this evidence showing, I'm sure you've seen
17 this.

18 MR. SIPE: Well, I saw it this afternoon.

19 COMMISSIONER MULVEY: And it does look as
20 though the amount of revenue for the short haul both
21 on a revenue per mils per ton mile basis on on
22 revenues per ton very must less favor the short line.
23 Are these numbers representative of shipments when it

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1 has to be revenue division between two railroads?

2 MR. SIPE: I certainly can't say that they
3 are representative, Commissioner Mulvey. What I can
4 tell you is this: That Otter Tail's regressions that
5 drive the vast majority of the revenue allocation
6 consisted of five movements on which the BNSF portion
7 was less than 200 miles. And these are two of the
8 five.

9 COMMISSIONER MULVEY: A regression with
10 five observations?

11 MR. SIPE: Yes. None of which was a
12 Powder River Basin coal movement. I mean, I just
13 don't think you can place any credence in that at all,
14 even if you were to say that what happens in the real
15 world is a valid paradigm for what happens in a
16 contestable market. And I don't think you can say
17 that.

18 COMMISSIONER MULVEY: I'm just wondering
19 what kind of confidence in a regression based on five
20 observations?

21 MR. SIPE: We put in a detailed study of
22 their regressions. And I think, frankly, we knocked
23 that out of the park. We have no confidence in it.

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1 CHAIRMAN NOBER: Let's come back to this
2 issue.

3 MR. WEICHER: I just wanted to make one
4 additional comment, Commission Mulvey. And I guess we
5 are not, and I assume we can't discuss in public the
6 details of these exhibits he gave you, but there are--
7 and a lot of this is in our evidence. But there are
8 issues in terms of the nature of these movements and
9 in a contestable market, the elasticity or
10 inelasticity of one or the other end of these sample
11 movements that make them completely inappropriate to
12 compare it to coming out the Powder River Basin on a
13 short haul division. I realize that's sort of a
14 mouthful.

15 COMMISSIONER MULVEY: Yes.

16 MR. WEICHER: But in addition to how few
17 samples they are, they're irrelevant to the texture of
18 what is supposedly being created here, a stand alone
19 railroad.

20 COMMISSIONER MULVEY: The one thing that
21 you said in your testimony was about this crossover
22 traffic and that 95 percent of the traffic in this
23 instance is crossover traffic. But our approach

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1 permits crossover traffic. But do you feel that there
2 should be some sort of cap on how much traffic that's
3 accepted or what percent would be too much?

4 MR. WEICHER: We have argued before there
5 should be a cap out and the Board reject that. Things
6 like 50 percent or so. But that issue doesn't have to
7 be reached here from the standpoint, as Mr. Sipe has
8 gone through and I tried to explain.

9 The principle of sharing of facilities is
10 violated here by all this traffic coming south from
11 Cordero and Donkey Creek. It doesn't use the same
12 railroad except artificially when you loop in a bit of
13 crossover that goes north that comes from a mine
14 farther south that you can get an overloop. This is a
15 construct on a construct. It is not proper crossover
16 traffic, at least and you know Mr. Sipe referred to
17 one of these two cases, nothing like you've ever done
18 in a western coal case that I'm aware of and something
19 that would be economically a real stretch, an abuse of
20 crossover and crossover.

21 CHAIRMAN NOBER: Let's turn to
22 productivity, which again I guess been an issue in the
23 last five or six straight cases, as you know. And what

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1 I'm struggling to understand is what is a fair measure
2 here. And, you know, the shippers here presented some
3 evidence and they've talked about some productivity
4 gains that they might achieve and how the RCAF-As even
5 calculated it if it's a ruling average of past-
6 productivity. And the question is why is it not fair
7 to say that a SARR might gain some productivity and at
8 this point the same productivity that a class 1 would
9 gain?

10 MR. SIPE: Well, I think --

11 CHAIRMAN NOBER: What productivity BN
12 getting that the SARR wouldn't?

13 MR. SIPE: There are two questions there,
14 and let me start with the first one.

15 CHAIRMAN NOBER: Okay.

16 MR. SIPE: I don't disagree with the
17 proposition that a SARR might realize some
18 productivity in the future. But I think in the context
19 of an adjudication where the evidence is going to be
20 based on substantial evidence of record, there is not
21 substantial evidence of record submitted by the
22 shipper in this case that shows you what such
23 productivity is. I mean, if that sounds --

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1 CHAIRMAN NOBER: Well, they put up a list
2 of 15 different things.

3 MR. SIPE: They put up a list of factors.
4 They put up 314,000 pound railcars.

5 CHAIRMAN NOBER: They --

6 MR. SIPE: Have you guys talked to Carl
7 Ice about when those 315,000 pound railcars are coming
8 on line? I mean, it's all conjecture. That's not
9 evidence. You've got to try and quantify it, tie it to
10 the numbers in the record.

11 MR. WEICHER: They have put in a list of
12 things that could result in productivity but not
13 evidence of what -- or anyone's real prediction that
14 specific items could occur that would lead to a
15 specific productivity included to reflect what they're
16 asking for the index.

17 CHAIRMAN NOBER: Well, isn't what's before
18 us to decide whether or not a stand alone railroad is
19 entitled to the same assumption of productivity
20 increases that a class 1 would be? And up to now the
21 argument has been well, you know, the class 1 -- a
22 brand new railroad would be state of the art and the
23 class 1 is still bringing itself to state of the art,

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1 if you will. So the class 1 will achieve productivity
2 increases that a brand new railroad wouldn't. And the
3 question is is that really true going forward?

4 MR. SIPE: Well, that is an interesting
5 question.

6 CHAIRMAN NOBER: I'm just trying to
7 understand the point.

8 MR. SIPE: But I think --

9 CHAIRMAN NOBER: Well that's what we have
10 to decide.

11 MR. SIPE: No, it's a question that has to
12 be decided in the context of the record in this case.
13 I mean, I will say as a counsel for BNSF that I did
14 not believe that we were under an obligation to come
15 in and make a showing to the Board about our real
16 world productivity. Maybe the Board wants to ask us
17 to do that in a future case. But I think where the
18 Board --

19 CHAIRMAN NOBER: But that's not what I
20 asked. I asked -- what I asked was what -- they give
21 a list of productivity; you said it speculative, can't
22 accept it. So I said well what then would they not be
23 entitled to. So I mean essentially you've met --

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1 their evidence you've responded to by saying well it's
2 not true.

3 MR. SIPE: Well, we didn't --

4 CHAIRMAN NOBER: Am I missing something.

5 MR. SIPE: We didn't have a chance to
6 respond to it, Chairman Nober. It came in on rebuttal.
7 If you'd like to ask us now to submit evidence on
8 that, we'll do it. But I can't refer to evidence that
9 we haven't produced.

10 CHAIRMAN NOBER: I guess what I'm trying
11 to get at is what would they have to show in order to
12 satisfy you that they have met -- not to satisfy me,
13 but to satisfy you.

14 MR. SIPE: Well it would be hard to
15 satisfy me.

16 CHAIRMAN NOBER: Could it be done?

17 MR. SIPE: How about let's take a
18 hypothetical reasonable person.

19 CHAIRMAN NOBER: Or me, for example.

20 MR. SIPE: And that would be you.

21 CHAIRMAN NOBER: Or us collectively, yes.

22 MR. SIPE: That would be the three of you
23 and your esteem advisors collectively.

1 What I think it would take to satisfy you
2 reasonable people would be something that showed a
3 correlation between specific areas of productivity and
4 a particular operating cost that escalates over time,
5 like labor, like locomotive maintenance;.show me the
6 nexus.

7 CHAIRMAN NOBER: Should we assume one man
8 crews or assume the same rate that class 1s are
9 assuming one man crews?

10 MR. SIPE: No, I wouldn't -- I wasn't
11 aware that class 1s were assuming that. But I --

12 CHAIRMAN NOBER: They're hoping for,
13 excuse me.

14 MR. SIPE: I don't think on this record,
15 unfortunately, you can do that. And I know maybe that
16 sounds like a lawyerly response, but that's part of
17 what we're up to here.

18 MR. WEICHER: Well, I don't know if it's
19 both a lawyerly and a practical response from a
20 railroad standpoint. I don't know how you could assume
21 in the context of something like this those kinds of
22 dramatic changes. Might they occur sometime in the
23 future? It is possible. These are goals of an

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1 industry. But how you could assume that in the
2 context of a rate case without concrete evidence,
3 especially for coal trains to assume dramatic
4 productivity increases when this is already one of the
5 most efficient that runs on a railroad. There's
6 always an issue in contract negotiations or issues
7 with utilities. From the railroad standpoint these
8 areas are already highly efficient. This is the
9 ordinary stuff. But you can't, I don't think, simply
10 assume dramatic changes in the future based on someone
11 saying a list of here are things that could happen,
12 especially in such serious areas.

13 COMMISSIONER MULVEY: Well, there are
14 several kinds of productivity increases. There are
15 some productivity increases that rain down like manna
16 from heaven and effect all railroads. These would be
17 things like major technological changes that come into
18 the future and that all railroads can adopt. Other
19 productivity increases come out of changes in
20 operations where the railroad becomes more efficient
21 over time.

22 So you could possibly separate out those
23 two kinds of productivity increases and say that well

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1 the ones that the portion of productivity increases
2 that have come from technological change, that is that
3 effects all railroads equally, you might be able -- I
4 mean, there are ways of doing this. I do think the
5 Board needs to look at it because I think we all sort
6 of agree that both the RCAF-U and the RCAF-A are two
7 extremes, neither of which fully capture what the
8 potential is over the long haul.

9 So it's something, I think, that needs
10 further investigation.

11 MR. WEICHER: If I may, Commissioner
12 Mulvey, it's self-serving to say this but I think my
13 company is already a low cost carrier, if not the
14 lowest cost carrier. And therefore to assume the most
15 dramatic productivity changes would be pretty radical.

16 But also, as you said, this has been
17 raised at least in the other proceeding, nonproceeding
18 or whatever, on SAC. Because it does have
19 ramifications across industry data.

20 COMMISSIONER MULVEY: You also mentioned
21 cost-based versus market-based estimates. Are you all
22 concerned about the philosophical issue involved here?
23 We start getting back to cost-based analysis and we

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1 start moving away from the whole purpose of
2 deregulation, getting away from cost-based
3 calculations and focusing on the market and the
4 demand-based calculations?

5 MR. SIPE: Well if I understand the
6 question correctly, I think there is a concern that
7 any cost-based revenue allocation is going to have an
8 element of arbitrariness that you wouldn't get by
9 observing actual through rates made in a real market.
10 But the reason why it's okay to use a defendant
11 carrier's real through rates is that those rates made
12 in a real market and you are in some sense testing not
13 just the rate of the challenged shipper, you're
14 testing a subset of rates.

15 There are no rates on crossover traffic.
16 Be definition they simply don't exist. It's like a
17 unicorn or a jackalope. And the best you're going to
18 be able to do is come up with, I think the Board has
19 used the word, precision. It's going to be an
20 approximation, and that's dangerous.

21 COMMISSIONER MULVEY: Thank you.

22 CHAIRMAN NOBER: Okay. Well, Mr. Weicher
23 thank you very much.

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1 Mr. DiMichael, I think you've reserved six
2 minutes.

3 MR. DiMICHAEL: Yes. Thank you, Chairman
4 Nober. Let me just address several things here,
5 perhaps some of them in reverse order that Mr. Sipe
6 talked about them.

7 Concerning productivity. Mr. Sipe said
8 that a reasonable man would ask that there would be a
9 correlation between specific areas of productivity and
10 specific operating costs. And I would submit to you
11 that if that is the test, it will be impossible for
12 anyone to tell whether five, one, two, three, five,
13 ten years from now there is going to be specific areas
14 of productivity that you can link to specific
15 operating costs and then tell how much that is going
16 to be.

17 I would tell you that I don't believe that
18 that is the test. As Commissioner Mulvey said, to
19 some extent the RCAF-A and the RCAF-U have been sort
20 two extremes and the Board is attempting to find out
21 instead of going to one extreme or the other, just
22 where the balance ought to be.

23 Now, Mr. Weicher said that all we did is

1 give you a list of factors, all conjuncture. I
2 totally disagree with that. Obviously, the list we
3 have here is simply a list. But that is backed up in
4 the record with literature from the industry
5 indicating that these are likely areas of productivity
6 and indicating likely when they are going to be.

7 Now, I don't think that there is really
8 anything that -- that the Board is going to demand a
9 specific linking in time and place and amount, it is
10 not going to happen. The Board does not and cannot do
11 that in its own productivity adjustment. But it seems
12 to me what we have given the Board here is evidence it
13 has not had in previous cases to make a reasoned
14 judgment, a judgment based on substantial evidence in
15 the record when the Board said there is this one and
16 there is this other, and we don't know where. We have
17 told you at least some factors where you can find
18 where this productivity is going to be and when it's
19 going to be. And we think that you should either now
20 say there is enough in the record to say the RCAF-A is
21 proper or at least to say that the RCAF-U is okay for
22 the first few years, but by that time there is enough
23 time gone past and enough productivity gains that we

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1 can assume that it is likely that the arrow will now
2 point more toward the RCAF-A.

3 Commissioner Mulvey, you mentioned very
4 quickly about Otter Tail's regressions. I will tell
5 you that -- I'll refer to the OTP rebuttal evidence
6 Volume 3A14 for a very detailed discussion of the
7 central limit theorem that will explain how when you
8 apply the statistics over and over again to various
9 movements, the confidence factor for the total becomes
10 actually a very small one. We totally disagree with
11 Mr. Sipe on that question, and we think the central
12 limit theorem will answer all of those questions.

13 COMMISSIONER MULVEY: Was this a mixing of
14 a cross section getting this data together? Was it
15 different observations over time?

16 MR. DiMICHAEL: I would not even begin to
17 try to answer that question.

18 COMMISSIONER MULVEY: Because there's a
19 few tests for that as to whether or not it's a valid
20 thing to do, and I was wondering because --

21 MR. DiMICHAEL: I was hoping you would
22 just simply write down the reference and --

23 MR. SIPE: The central limit theorem.

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1 MR. DiMICHAEL: Concerning the modeling,
2 there was a number of questions here asked about the
3 modeling. And, frankly, the matter -- this is a very
4 similar situation to the question that the Board
5 already decided in the PPL case. In that case the
6 shipper the Board said had an incentive, had a very
7 great incentive to put its best case in, and it
8 didn't. And it now can't say well, gee, I thought
9 maybe I didn't have to do it because of some other
10 circumstances.

11 The Board here is faced with the exact
12 same question as far BN was concerned. BN may have
13 had reasons, perhaps, and I don't agree with that for
14 sure, of why they didn't model the whole thing. And,
15 frankly, they had an incentive to do the very best
16 case they can. And the very best case they can should
17 have been the entire model start to finish. So they
18 cannot opine now that there was something that they
19 did that they shouldn't have did. Or something that
20 they didn't do that they should have done.

21 Now concerning the dwell times. BN's
22 evidence on the dwell times is based basically on its
23 own operations in its own yards, which unlike the

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1 Otter Tail railroad yard are located several hundred
2 miles from the Powder River Basin.

3 Otter Tail's evidence on dwell times and
4 yard capacity has been based on a feasible plan which
5 is actually the plan that WRPI used and that now UP
6 uses where the UP has a yard basically in the Powder
7 River Basin. UP operates its yard very differently
8 from the way the BN operates its yard. So what we are
9 telling you is that we think you can certainly credit
10 the Otter Tail times.

11 Just one more quick thing. Mr. Sipe
12 talked about the 25 mile revenue division, and I would
13 refer the Board to our supplemental rebuttal, Exhibit
14 3A13 where we make a very detailed response to that.
15 That was some of the stuff, that was some of the
16 material that I was explaining to you today.

17 And I thank you very much.

18 COMMISSIONER MULVEY: Thank you.

19 CHAIRMAN NOBER: With that, I want to
20 thank the parties on both sides for their excellent
21 preparation and tremendous argument. And I think that
22 a lot of the real core issues in the case were
23 addressed today. And I'm sorry it was a long

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1 discussion, but that meant that we were having a full
2 one.

3 And on behalf of the Board, I want to
4 thank you all for your time and your energy and your
5 attention.

6 And the Board stands adjourned.

7 Thank you very much.

8 (Whereupon, the above-entitled matter was
9 concluded at 3:32 p.m.)
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