

SLOVER & LOFTUS

ATTORNEYS AT LAW

1224 SEVENTEENTH STREET, N. W.
WASHINGTON, D. C. 20036-3003

WILLIAM L. SLOVER
C. MICHAEL LOFTUS
JOHN H. LE SEUR
KELVIN J. DOWD
ROBERT D. ROSENBERG
CHRISTOPHER A. MILLS
FRANK J. PERGOLIZZI
ANDREW B. KOLESAR III
PETER A. PFOHL
DANIEL M. JAFFE
KENDRA A. ERICSON

OF COUNSEL
DONALD G. AVERY

ENTERED
Office of Proceedings

JUL 03 2006

Part of
Public Record

TELEPHONE:
(202) 347-7170

FAX:
(202) 347-3619

WRITER'S E-MAIL:

June 30, 2006

BY HAND DELIVERY

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



Re: Docket No. 42088, *Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company*; Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* - 216915

Dear Secretary Williams:

Enclosed for filing are the original and twenty copies of the Additional Rebuttal Comments of Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. in the above-referenced proceedings.

Kindly acknowledge receipt of the enclosed pleading by date-stamping and returning the enclosed extra copy of this letter to our messenger.

Sincerely

John H. LeSeur

cc: Counsel for BNSF
Parties to Service List



**BEFORE THE
SURFACE TRANSPORTATION BOARD**

MAJOR ISSUES IN RAIL RATE CASES

Ex Parte No. 657 (Sub-No. 1)

WESTERN FUELS ASSOCIATION, INC.)
and BASIN ELECTRIC COOPERATIVE, INC.)
v. BNSF RAILWAY COMPANY)

STB Docket No. 42088

**ADDITIONAL REBUTTAL COMMENTS
OF
WESTERN FUELS ASSOCIATION, INC. AND
BASIN ELECTRIC POWER COOPERATIVE, INC.**

Office of Proceedings

JUL 03 2006

Part of
Public Record

OF COUNSEL:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Dated: June 30, 2006

By: John H. LeSeur
Christopher A. Mills
Peter A. Pfohl
Daniel M. Jaffe
1224 17th Street
Washington, D.C. 20036
(202) 347-7170

**Attorneys for
Western Fuels Association, Inc. and
Basin Electric Power Cooperative, Inc.**

TABLE OF CONTENTS

PREFACE	2
I. RATE RELIEF METHODOLOGIES	3
A. RAM is Superior to Percent Reduction	3
B. Carrier Commenters Offer Only Mistaken Critiques of RAM	5
(1) RAM Complies with the <u>Guidelines</u>	5
(2) RAM has not been Rejected in Prior Cases	6
C. The Reduced Mark-up Method is Superior to Percent Reduction	8
D. MCM and MMM are Superior to Percent Reduction	10
E. The Board Should Reject BNSF's Proposed Rate Relief Mechanisms	11
II. CROSS-OVER TRAFFIC DIVISIONS METHODOLOGY	12
A. The Board Should not Adopt the ATC Methodology	12
B. If the Board Adopts ATC, it Cannot Retroactively Apply ATC in <u>Western Fuels</u>	13
C. The Board Should Apply MSP Divisions in <u>Western Fuels</u>	16
III. OTHER ISSUES	18
CONCLUSION	19

REBUTTAL EXHIBITS

Congressional Letter to the STB	1
WFA/Basin's Rebuttal Evidence – LRR Configuration	2

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

	)	
	)	
MAJOR ISSUES IN RAIL RATE CASES	)	Ex Parte No. 657 (Sub-No. 1)
	)	
	)	
	)	
WESTERN FUELS ASSOCIATION, INC.	)	
and BASIN ELECTRIC COOPERATIVE, INC.	)	STB Docket No. 42088
v. BNSF RAILWAY COMPANY	)	
	)	

**ADDITIONAL REBUTTAL COMMENTS OF
WESTERN FUELS ASSOCIATION, INC. AND
BASIN ELECTRIC POWER COOPERATIVE, INC.**

Western Fuels Association, Inc. ("WFA") and Basin Electric Power Cooperative, Inc. ("Basin Electric")¹ join in the Rebuttal Comments filed by the Coal Shippers.² WFA/Basin file these Additional Rebuttal Comments to address issues specific to the Western Fuels rate case³ raised in the Reply Comments of BNSF Railway Company ("BNSF") and the Reply Submission of Union Pacific Railroad Company ("UP").

¹ WFA and Basin Electric are collectively referred to as "WFA/Basin."

² Joint Rebuttal Comments of Western Coal Traffic League, Concerned Captive Coal Shippers, Western Fuels Association, Inc., Edison Electric Institute, National Rural Electric Cooperative Association and American Public Power Association.

³ Western Fuels Ass'n, Inc. and Basin Elec. Coop., Inc. v. BNSF Ry. Co., STB Docket No. 42088.

PREFACE

These Additional Rebuttal Comments constitute the ninth round of evidentiary-related filings involving the Western Fuels case.⁴ WFA/Basin, and the rural electric consumers they represent, continue to pay outrageously high rail rates as these proceedings drag out. WFA/Basin have previously articulated in detail their concerns about the legality, and propriety, of these delays and the forced interaction of this rulemaking proceeding with the closed Western Fuels evidentiary record. These concerns are shared by others charged with representing the interests of the rural consumers served by the Laramie River Station (“LRS”).⁵

WFA/Basin look to the Surface Transportation Board (“STB” or “Board”) as their last line of defense against BNSF’s monopoly price increases. As they have done throughout these proceedings, WFA/Basin again respectfully request that the Board promptly decide the Western Fuels case and grant the rate relief WFA/Basin request. All of this relief will flow through to electric consumers served by LRS.

⁴ These filings include three rounds of evidentiary filings in Western Fuels in 2005, a fourth round of filings in Western Fuels in 2005 related to BNSF’s motion to strike; two prior rounds of filings in this proceeding in 2006; and two rounds of filings in Western Fuels in 2006 in response to the Board’s March 17, 2006 Compliance Order.

⁵ See letter from 14 Members of Congress to the Hon. W. Douglas Buttrey and the Hon. Francis P. Mulvey, dated May 2, 2006, appended as Rebuttal Exhibit 1.

I.
RATE RELIEF METHODOLOGIES

In Western Fuels, WFA/Basin presented two rate relief methodology alternatives to the percent reduction method: the Reasonable Allocation Method (“RAM”) and the Reduced Mark-up Method. For the most part, BNSF presents the same bogus criticisms of RAM, and Reduced Mark-up, in this proceeding that BNSF presented in Western Fuels and WFA/Basin refuted in Western Fuels.

As WFA/Basin demonstrated in their Opening Comments, the Board should set movement-specific stand-alone railroad (“SARR”) rates for the Laramie River Railroad (“LRR”) using RAM or the Reduced Mark-up Method. If the Board disagrees, however, the Board’s proposed Maximum Contribution Method (“MCM”) or its proposed Maximum Mark-up Methodology (“MMM”) can be fairly applied in Western Fuels assuming they are used with Modified Straight Mileage Prorate (“MSP”) divisions. See WFA/Basin Additional Op. Comments at 22-23.

A. RAM is Superior to Percent Reduction

WFA/Basin described in detail the many attributes of RAM in their evidentiary presentations in Western Fuels. WFA/Basin have resubmitted that evidence as part of their comments in this proceeding. RAM also is thoroughly addressed in the Opening and Rebuttal Comments submitted by Coal Shippers.

Under RAM, each LRR shipper pays its variable costs. Captive LRR shippers pay an additional sum equal to a pro-rata share of the non-attributable LRR

costs (i.e. the difference between total LRR stand-alone costs (“SAC”) and LRR system variable traffic costs). RAM also contains a default rule – no shipper is required to pay more than its current rate.

RAM has many attributes, including the following:

- RAM solves the principal flaw in the Board’s percent reduction methodology – the defendant carrier’s starting rate dictating the maximum SAC rate. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-14 to III-H-16.

- RAM also addresses carrier concerns about high rate/cost differentials on cross-over traffic. Under RAM, such high differentials do not impact SARR movement-specific SAC rates. See WFA/Basin Reb. Evidence, STB Docket No. 42088 (filed Sept. 30, 2005) at III-A-11.

- RAM complies with the Coal Rate Guidelines;⁶ adheres to governing ICC and STB precedent; and its use is fully supported in the Western Fuels case record. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-16 to III-H-33.⁷

⁶ Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 536 (1985), aff’d sub nom., Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3rd Cir. 1987) (“Guidelines”).

⁷ Coal Shippers Opening Comments also discuss in detail the many positive features of RAM. See Coal Shippers Op. Comments at 22-25.

**B. Carrier Commenters Offer
Only Mistaken Critiques of RAM**

BNSF offers the same mistaken challenges to RAM that it presented in Western Fuels. UP also repeats some of these misguided assertions in its Reply Submission.

(1) RAM Complies with the Guidelines

BNSF and UP argue that the Board should reject RAM because the Guidelines permit a pro-rata distribution of unattributable costs to SARR shippers only if those shippers have “identical” demand characteristics. See BNSF Reply Comments at 14; UP Reply Submission at 7. This reading of the Guidelines is wrong. The Guidelines expressly permit and encourage complainant shippers to allocate unattributable SARR costs among SARR traffic group members with “similar demand elasticit[ies].” Id., 1 I.C.C. 2d at 533. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-16 to III-H-21; Coal Shippers Reb. Comments, V.S. Crowley at 16-21.

The Guidelines also provide that a complaining shipper can present qualitative evidence to demonstrate that a subset of SARR traffic group members possess similar demand elasticities. See Guidelines, 1 I.C.C. 2d at 527. WFA/Basin presented extensive case-specific evidence in Western Fuels demonstrating that the LRR captive shipper subgroup – all of whom are baseload utility Powder River Basin (“PRB”) coal shippers – had similar demand elasticities. See WFA/Basin Additional Op. Comments, Exhibit 1A at III-H-23 to III-H-28; Exhibit 1B at III-H-28 to III-H-33.

BNSF hypothesizes, both in Western Fuels and in the instant proceeding, that the captive coal shippers in the LRR traffic group face different forms of product and geographic competition, and therefore do not have similar demand elasticities. However, as WFA/Basin demonstrated in Western Fuels, BNSF offers no credible empirical evidence to support its claims; BNSF's argument conflicts with the contrary positions it has taken in recent coal rate cases; and BNSF's contentions ignore the economic reality that all baseload PRB-fired powerplants that are captive to BNSF share a common degree of highly inelastic demand for rail service.⁸

(2) RAM has not been Rejected in Prior Cases

BNSF also argues, as it did in Western Fuels, that RAM has been "rejected" in prior cases. See BNSF Reply Comments, V.S. Kalt at 24. The RAM procedure is modeled on the methodology that the ICC used and approved in OPPD⁹ and APL¹⁰ to set SARR-specific SAC rates. In those cases, all SARR shippers paid their variable costs and captive coal shippers in the SARR traffic groups (all of whom were utility PRB coal shippers) paid the SARRs unattributable costs on a pro-rata ton-mile basis. The ICC approved this pro-rata distribution of unattributable costs because the complainant

⁸ See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-28 to III-H-33; Coal Shippers Reb. Comments, Crowley V.S. at 21-23, 80-86.

⁹ Omaha Pub. Power Dist. v. Burlington N. R.R., 3 I.C.C.2d 123, 139-40 (1986), aff'd on appeal 3 I.C.C. 2d 853 (1987).

¹⁰ Arkansas Power & Light Co. v. Burlington N. R.R., 3 I.C.C.2d 757, 774 (1987).

shippers demonstrated that the captive PRB utility coal shippers had similar elasticities of demand. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-19 to III-H-21; Coal Shippers Reb. Comments, V.S. Crowley at 18-20.

In cases presented and decided since OPPD and APL, complainant shippers have not asked the ICC, or the STB, to apply a procedure where each SARR shipper pays its variable costs and unattributable SAC costs are distributed among a class of shippers with similar demand elasticities. Thus, the ICC and the Board have not rejected the divisions methodology used in OPPD and APL – and the methodology RAM is based upon – because it has not been presented in subsequent cases. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-22 to III-H-27; Coal Shippers Reb. Comments, V.S. Crowley at 20-21.

The ICC, and the Board, have considered – and rejected – other methodologies calling for a pro-rata distribution of all SAC costs, to all SARR shippers. See Coal Trading;¹¹ WTU;¹² APS I;¹³ and CPL I.¹⁴ RAM is fundamentally different than those rejected methodologies because RAM allocates only unattributable SARR costs on

¹¹ Coal Trading Corp. v. The Baltimore & Ohio R.R., 6 I.C.C.2d 361 (1990).

¹² West Tex. Utils. Co. v. Burlington N. R.R., 1 S.T.B. 638 (1996), aff'd sub nom. Burlington N. R.R. v. STB, 114 F.3d 206 (D.C. Cir. 1997).

¹³ Arizona Pub. Serv. Co. v. Atchison, Topeka and Santa Fe Ry., 2 S.T.B. 367 (1997).

¹⁴ Carolina Power & Light Co. v. Norfolk S. Ry., STB Docket No. 42072 (STB served Dec. 23, 2003).

a pro-rata basis and because RAM conservatively allocates those costs only to a subset of the SARR traffic group that has similar demand elasticities. See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-22 to III-27.

**C. The Reduced Mark-up Method
is Superior to Percent Reduction**

WFA/Basin presented a second alternative to percent reduction in Western Fuels – the Reduced Mark-up Method. The Reduced Mark-up Method is intended to work in the general form of the Board’s current, flawed percent reduction methodology but it makes some obvious corrections – e.g., it reduces SARR shippers’ profit contributions, not simply their rates. Under the Reduced Mark-up Method, the profit contribution made by each LRR shipper is calculated. This profit contribution is the difference between the revenues paid by each LRR shipper and the variable costs the LRR incurs to provide that shipper with service. The contribution is then reduced on a pro-rata basis so that LRR revenues equal LRR costs. See WFA/Basin Additional Op. Comments at 16-17.

The Reduced Mark-up Method uses R/VC ratios as a surrogate for Ramsey demand elasticity calculations. It also responds to the Board’s Xcel I decision.¹⁵ In Xcel I, the Board criticized Xcel’s proposed R/VC ratio methodology for determining

¹⁵ Pub. Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. and Santa Fe Ry., STB Docket No. 42057 (STB served June 8, 2004).

movement-specific SARR rates because “all movements in the traffic group with R/VC percentages in excess of the R/VC cap would be expected to bear equal shares of the SAC costs on an R/VC basis, even where they have differing demand elasticities.” Id. at 38.

The Reduced Mark-up Method, unlike the method the Board rejected in Xcel I, does not require LRR group members “to bear equal shares of the SAC costs . . . even where they have differing demand elasticities.” Id. Instead, the Reduced Mark-up Method provides for each LRR shipper to bear different shares of SAC costs based on their profit contribution.

As it did in Western Fuels, BNSF claims the Reduced Mark-up Method should not be used because it measures SARR unattributable costs as the difference between SARR rates and SARR variable costs (measured using URCS).¹⁶ According to BNSF, the Guidelines call for the calculation of economic marginal costs that are not reflected in URCS-based accounting costs.¹⁷

The Board has only one official methodology to calculate rail costs – URCS. And, the Board has ruled in post-Guidelines decisions that URCS can be used to estimate marginal costs for ratemaking purposes. See Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1027 (1996) (“[b]ecause the marginal costs associated with handling particular rail traffic are not readily measureable, we rely on the variable costs

¹⁶ UP makes a similar claim. See UP Reply Submission at 10-11.

¹⁷ See BNSF Reply Comments, V.S. Kalt at 27.

produced by the URCS formula as proxy for LRMC [long run marginal costs].” See also Coal Shippers Reb. Comments, V.S. Borts at 4-5, V.S. Crowley at 29-42.

**D. MCM and MMM are Superior
to Percent Reduction**

WFA/Basin agree with Coal Shippers that the Board’s proposed MCM and MMM methods are superior to the Board’s current percent reduction methodology. As WFA/Basin explained in their Opening Comments, the Board should apply RAM or Reduced Mark-up in the pending Western Fuels case. However, if the Board decides not to do so – and the choice becomes one of applying percent reduction or MCM/MMM – WFA/Basin believe both MCM and MMM are superior to percent reduction and could be fairly applied in Western Fuels (assuming as discussed below, they are used with MSP divisions). The evidence needed to apply the methods exists in the Western Fuels case record and, as Coal Shippers discuss in their comments, both methods improve upon percent reduction because they reduce the defendant carrier’s ability to manipulate the outcome of SAC cases.¹⁸

The Board also should reject BNSF’s claim that MMM and MCM cannot be applied in the Western Fuels case because there is no evidence in Western Fuels that BNSF “gamed” the percent reduction method by charging rates that are not

¹⁸ If the Board asks for post-rulemaking supplemental evidence in Western Fuels on rate relief methodologies, the Board should permit WFA/Basin to select the relief methodology of their choice (as applied to existing record evidence) and defend that selection in the ensuing proceedings.

“commercially sustainable.” See BNSF Op. Comments at 43. This is a red-herring argument. As WFA/Basin demonstrated in their prior submissions in Western Fuels, and in this proceeding, the fundamental problem with percent reduction is that it allows the defendant carrier to dictate the SAC answer. MMM and MCM address this problem and can be fairly applied in Western Fuels.

**E. The Board Should Reject BNSF’s
Proposed Rate Relief Mechanisms**

In its Comments, BNSF urges the Board to set maximum rates using two alternative methodologies: one based on avoided cost divisions and a second based on so-called “through rate” reductions. See BNSF Op. Comments at 47. BNSF served-up the same proposals in Western Fuels.

WFA/Basin addressed each proposal in Western Fuels and each must be rejected. BNSF’s avoided cost rate relief method is predicated upon a long-rejected cross-over traffic divisions methodology – avoidable costs. This method relies on the incorrect assumption that a SARR is a competitor of, and not a replacement for, the incumbent and sets a SARR’s cross-over traffic divisions at impermissibly low levels.¹⁹ Similarly, BNSF’s proposed through-rate divisions method is a gimmick approach where

¹⁹ See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-37 to III-H-38; Coal Shipper’s Reply Comments at 24-27.

SARR revenues are not reduced to equal SARR costs – a result that violates the Guidelines.²⁰

II.

CROSS-OVER TRAFFIC DIVISIONS METHODOLOGY

WFA/Basin agree with Coal Shippers and other commenters, including UP, that the Board should not adopt its proposed Average Total Cost (“ATC”) divisions methodology. If the Board disagrees, it would be fundamentally unfair to retroactively apply ATC to set LRR cross-over traffic divisions in the pending Western Fuels case.

A. The Board Should not Adopt the ATC Methodology

The Board should not adopt its proposed ATC divisions methodology. The reasons why the Board should not do so are fully articulated in the Opening, Reply and Rebuttal comments submitted by Coal Shippers. These grounds include the following:

- The ATC method attempts to do the impossible – fairly allocate fixed costs to individual movements using accounting techniques.
- The ATC method allocates system-average fixed unit costs to each mile of track in violation of the Board’s holding in Duke/NS I²¹ that any such allocations must use line-specific data.

²⁰ See WFA/Basin Additional Op. Comments, Exhibit 1B at III-H-38 to III-H-40.

²¹ Duke Energy Corp. v. Norfolk S. Ry., STB Docket No. 42069 (STB served Nov. 6, 2003).

- The ATC method ignores relevant actual market divisions data, data which must be considered to produce meaningful results.

- As a result, the ATC method assigns far too little revenue to high density SARR lines.

Significantly, UP agrees that ATC cannot be used for SARR division purposes²² and other railroad commenters concede, as they must, that ATC contains a fatal flaw – it arbitrarily allocates fixed costs to individual traffic movements. For these, and the other, reasons detailed in the Coal Shippers’ comments, ATC cannot be used to calculate SARR divisions on cross-over traffic.

**B. If the Board Adopts ATC, it Cannot
Retroactively Apply ATC in *Western Fuels***

If the Board adopts ATC – which it should not – it would be fundamentally unfair for the Board to retroactively apply ATC to the pending Western Fuels case. As WFA/Basin demonstrated in their Opening Comments, a complainant shipper models its SARR based upon assumptions concerning SARR revenues and SARR costs. WFA/Basin modeled its SARR using MSP divisions – one of the two mileage-based approaches the Board has consistently approved for over a decade.²³ ATC is a fundamentally different method for calculating SARR divisions than MSP and, if ATC

²² See UP Reply Submission at 16-17.

²³ The other mileage approach is the Modified Mileage Block Prorate (“MMP”) method. See WFA/Basin Additional Op. Comments, Exhibit 2A at III-A-17 to III-A-18.

had been mandated at the start of the Western Fuels case, WFA/Basin would have modeled a SARR that had a different configuration and traffic group.

Neither BNSF, nor any other commenting party, disputes WFA/Basin's evidence that designing a SARR using ATC divisions would require WFA/Basin to model a substantially different SARR in order to "maximize the carriage of profitable traffic" as called for under the Guidelines.²⁴ Indeed, the sole purpose of ATC appears to be to prevent shippers from modeling efficient, high density SARRs since, under ATC, revenues needed to sustain such SARRs are arbitrarily shifted to lower density off-SARR lines under the guise of a "Full SAC" analysis.

BNSF argues that WFA/Basin has made no case against retroactive application of the ATC method because WFA/Basin's presentation is predicated on "fairness," instead of the "legal standards governing retroactivity." BNSF Reply Comments at 31. However, as the courts have observed on numerous occasions, a new rule will not be applied to a pending adjudication when it would be unfair to do so.²⁵ Also, in its Notice instituting this proceeding, the Board specifically requested

²⁴ Id. at 543.

²⁵ See, e.g., Cassell v. FCC, 154 F.3d 478, 486 (D.C. Cir. 1998) (retroactive application of new rule to pending cases typically "boil[s] down . . . to a question of concerns grounded in notions of equity and fairness"); Clark-Cowlitz Joint Operating Agency v. FERC, 826 F.3d 1074, 1082 n.6 (D.C. Cir. 1987) (same). Of course, had the Board properly complied with the governing statutory deadline, the Western Fuels case would not be pending when this rulemaking proceeding is completed -- it would have been finally decided. WFA/Basin have reserved all their legal rights concerning these Board actions. See WFA/Basin Additional Op. Comments at 22 n.17.

commenters to address the “equit[ies] of applying its proposals to pending cases.” See Notice at 2.

BNSF also argues that it is not unfair for the Board to retroactively apply the ATC divisions methodology in Western Fuels because the Board held in Duke/NS I that it intended cross-over divisions to be cost-based. See BNSF Reply Comments at 26. However, the Board also upheld the use of MSP in Duke/NS I as a reasonable cost-based divisions procedure, so BNSF’s contention is wrong. See Duke/NS I at 25.

Finally, BNSF argues that WFA/Basin’s position concerning the retroactive application of ATC demonstrates WFA/Basin was “gaming” the SAC process. See BNSF Reply Comments at 31. In fact, as Board counsel has candidly observed, BNSF “objects to any application of the SAC test that results in rate relief to captive shippers.”²⁶ A shipper is entitled under the Guidelines to model a “least costly” SARR that “maximize[s] the carriage of profitable traffic.” Id. 1 I.C.C.2d at 543. The universe of “profitable” cross-over SARR traffic is determined by calculating the revenue and costs associated with transporting that traffic. WFA/Basin reasonably relied on the MSP method to calculate SARR revenues on cross-over traffic – the longstanding Board-approved approach to set SARR divisions. WFA/Basin’s reliance on MSP was not

²⁶ Brief for Respondent STB, BNSF Ry. v. STB, No. 05-1030 (D.C. Cir. filed July 21, 2005) at 36.

“gaming” the Board’s SAC standards. Rather, WFA/Basin was properly adhering to the SAC standards as they existed when WFA/Basin submitted their case to the STB.²⁷

BNSF made the same misguided “gaming” contentions last year in Western Fuels. WFA/Basin provided a detailed point-by-point response in Western Fuels, and WFA/Basin reproduce that response in Exhibit 2 to these Rebuttal Comments. As WFA/Basin explained in detail in Western Fuels, WFA/Basin conservatively modeled the LRR in a manner that comported with all then-governing STB standards concerning SARR design, SARR construction and SARR revenue collections.

C. The Board Should Apply MSP Divisions in Western Fuels

As discussed above, the Board has consistently applied MSP/MMP divisions procedures for over a decade in rate cases preceding Western Fuels. Under governing Board precedent, the burden was on BNSF to present a superior alternative to MSP. BNSF clearly failed to meet that burden.

In Western Fuels, BNSF asked the Board to set SARR divisions using the same “avoidable costs” approach that the ICC and the Board had rejected in prior cases. WFA/Basin presented substantial evidence demonstrating that the prior ICC and Board decisions were correct. Setting SARR divisions at avoidable cost levels violates the Guidelines, and is intended solely to make cross-over traffic so unprofitable to a SARR

²⁷ See WFA/Basin Additional Op. Comments at 18-19; Coal Shippers Reb. Comments, V.S. Crowley at 58-61.

that the SARR would not include the traffic. Thus, BNSF's proposed avoidable costs method is clearly not superior to MSP.²⁸

BNSF also proposed a second method to set SARR divisions – a modified MSP. This modified MSP reduced the MSP origin and destination mileage blocks to 25 miles. In Otter Tail,²⁹ BNSF proposed the same modified MSP method and presented the same supporting evidence. The Board proceeded to reject BNSF's modified MSP approach, and consistent with prior decisions, used MSP to set cross-over traffic divisions. See Otter Tail at 15-17. Thus, modified MSP is clearly not superior to MSP.

The administrative record on divisions issues closed in Western Fuels in September of 2005. WFA/Basin reasonably relied on MSP divisions in presenting their case to the Board; BNSF failed to meet its burden of proof to develop an alternative superior to MSP; and, as discussed above, it is unfair, and unlawful, for the Board to retroactively apply ATC in Western Fuels. Accordingly, the Board must use the MSP method to set LRR divisions in Western Fuels.

²⁸ See WFA/Basin Additional Op. Comments at 18-19; Coal Shippers Reply Comments at 22-31.

²⁹ Otter Tail Power Co. v. Burlington N. and Santa Fe Ry., STB Docket No. 42071 (STB served Jan. 27, 2006).

III. OTHER ISSUES

The Board's Notice addresses three other issues that are directly pertinent to the Western Fuels case: (1) forecasting SARR operating expenses; (2) calculating variable costs for jurisdictional threshold purposes; and (3) determining the length of the discounted cash flow ("DCF") analysis period.

WFA/Basin and Coal Shippers have addressed these issues in detail in their prior submissions to the Board. These issues are also addressed in detail in the rebuttal comments presented by Coal Shippers. Based upon the extensive record, WFA/Basin request the Board to take the following actions in Western Fuels:

- SARR Operating Costs. The Board should apply the 0.59 RCAF-U index to forecast LRR operating cost changes. Based upon the record evidence they submitted last year in Western Fuels, WFA/Basin have demonstrated that the .059 RCAF-U index properly, and conservatively, captures productivity gains the LRR will experience over the twenty year discounted DCF period. Alternatively, WFA/Basin support the use of the SARR operating cost forecast procedures set forth in Coal Shippers Opening Comments. Id. at 88. These alternative procedures can be simply and easily applied using the existing record evidence in Western Fuels.

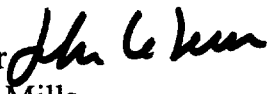
- Variable Costs. The Board should calculate the jurisdictional threshold in Western Fuels using WFA/Basin's adjusted URCS costs. See WFA/Basin Additional Op. Comments at 29.

- DCF Period. WFA/Basin and BNSF agree that the Board should use a twenty-year DCF period in Western Fuels. The Board should deny BNSF's request that the Board limit the Western Fuels prescription to ten years for the reasons set forth in WFA/Basin Additional Reply Comments. See id. at 8-9. As discussed therein, fundamental fairness dictates that the Board not retroactively reduce the Western Fuels rate prescription from twenty years to ten years.

CONCLUSION

WFA/Basin request that the Board promptly and fairly decide the Western Fuels case in accordance with governing law.

Respectfully Submitted,

By: John H. LeSeur 
Christopher A. Mills
Peter A. Pfohl
Daniel M. Jaffe
1224 17th Street
Washington, D.C. 20036
(202) 347-7170

OF COUNSEL:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Dated: June 30, 2006

Attorneys for
Western Fuels Association, Inc. and
Basin Electric Power Cooperative, Inc.

Congress of the United States

Washington, DC 20515

May 2, 2006

The Honorable W. Douglas Buttrey
Chairman
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

The Honorable Francis P. Mulvey
Vice Chairman
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Dear Chairman Buttrey and Vice Chairman Mulvey:

We have recently learned that the Surface Transportation Board (STB) has initiated a rulemaking involving the application of the stand-alone cost ("SAC") test in rail rate cases. We are very concerned about the impact of the Board's decision on rail customers who are awaiting final decisions in pending rate cases, and ask the Board to reconsider its decision.

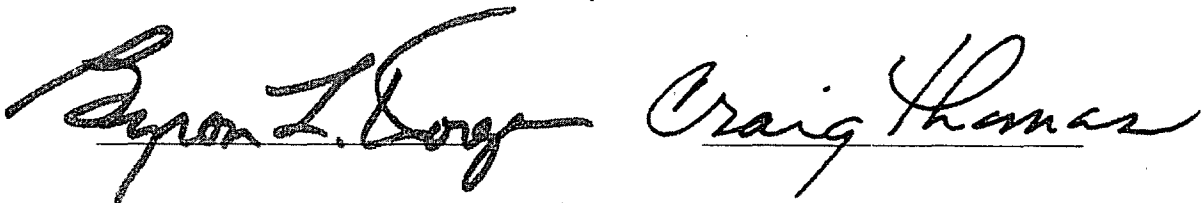
The STB's rulemaking is unfair to railroad customers awaiting decisions in pending cases. When the Board issued its rulemaking decision on February 27, it suspended several pending rate cases, including STB Docket No. 42088, Western Fuels Association, Inc. and Basin Electric Power Cooperative v. BNSF Railway Company and STB Docket No. 41191 (Sub-No. 1), AEP Texas North Company v. BNSF Railway Company.

The parties in each of these cases have already spent millions of dollars, generated tens of thousands of pages of evidence, and produced dozens of witnesses on each side. Until the STB initiated its rulemaking, both cases were awaiting final decisions by the Board. The statutory deadline established by Congress for deciding SAC cases has already passed in the AEP case, and it appears that a final decision in the Western Fuels/Basin Electric case will be delayed far beyond its deadline of September 2006.

The STB's rulemaking decision is troubling in many respects. Not only does it delay the Board's deadlines for deciding SAC rate cases, but it essentially requires the parties to these cases to participate in the rulemaking and resubmit evidence at considerable expense. And each day the Board delays in deciding these cases is another day the shippers involved are forced to pay exorbitantly high rail rates. Pending the outcome of the Board's decision, the rail customers involved are paying—and will continue to pay—tens of millions of dollars a year in rate increases; unnecessary delays in the Board's decision imposes a very real cost to those customers.

We are extremely concerned that the Board's SAC rulemaking initiative imposes an unnecessarily delay in these pending rate cases. The Board should not create additional barriers to rail customers who are trying to obtain relief, and we urge the Board to reconsider its decision and resolve the pending rate cases as quickly as possible.

Sincerely,

The block contains two handwritten signatures in black ink. The signature on the left is 'Byron L. Dorge' and the signature on the right is 'Craig Thomas'. Both signatures are written in a cursive, flowing style.

Steve Johnson

Ken Solayan

Tom Hark

Earl Pomeroy

Stephanie Puzos

Barbara Cubin

John Thune

Michael B. Fuzi

Chuck Grassley

Denny Rehberg

Tom Latham

Max Baucus

WFA/BASIN'S REBUTTAL EVIDENCE (PUBLIC VERSION)

STB DOCKET NO. 42088

RESPONSE TO BNSF GAMING CONTENTIONS

III. A. TRAFFIC GROUP

1. Stand-Alone Traffic

The LRR is designed to provide single-line origin-to-destination service from the PRB to LRS. The LRR also originates PRB coal deliveries for 36 other utility customers.¹ On these “cross-over” movements, the LRR transports the coal from PRB origin mines to various interchange points with the residual BNSF. The residual BNSF then transports the coal from the interchange points either to utility coal-fired plants or to interchange points with other carriers for movement beyond to utility coal-fired plants. All told, LRS-originated traffic moves to 75 power plant destinations.²

On reply, BNSF launches into a diatribe that accuses WFA/Basin of “gaming” the LRR traffic selection process.³ BNSF’s gaming rants are absurd in this case.

a. The LRR Traffic Group is Conservatively Configured

The Coal Rate Guidelines require a shipper to configure a SARR so that the SARR serves the origins and destination of the issue traffic.⁴ The Coal Rate Guidelines

¹ See WFA/Basin Op. Exhibit III-A-2.

² Id.

³ See BNSF Reply Narr. at III.A-5 to 15.

⁴ See Metropolitan Edison Co. v. Conrail, 5 I.C.C. 385, 420 (1989) (“we cannot permit a SAC model that does not use the actual origin and destination points of the issue traffic”). The destination refers to the destination of the issue traffic on the defendant carrier’s line.

permit and encourage shippers to augment the issue traffic with other traffic. This augmentation is called “grouping.” Grouping is essential for the SAC test to work. As the ICC explained in the Guidelines:

The ability to group traffic of different shippers is essential to theory of contestability. It allows the captive shipper to identify areas where production economies define an efficient subsystem or alternative system whose traffic is divertible to a hypothetical competitor. Without grouping, SAC would not be a very useful test, since the captive shipper would be deprived of the benefits of any inherent production economies.

Id. at 544.

The Coal Rate Guidelines also give a shipper broad rights to select its SARR traffic group. See id. (“[w]e see no need for any restrictions on the traffic that may potentially be included in a stand-alone group”). Similarly, the Guidelines provide the shipper with “broad flexibility” in modeling the “least costly” SARR:

The parties will have broad flexibility to develop the least costly, most efficient plant. The plant should be designed to minimize construction (or acquisition) and operating costs and/or maximize the carriage of profitable traffic. In selecting the route of a SAC railroad, for instance, an overriding factor may be the effort to lower costs by taking advantage of economies of density. Generally, a stand-alone railroad would attempt to fully utilize plant

capacity, adding other profitable traffic in order to reduce the average cost of operation.

Id. at 543.

The ICC and the Board have repeatedly reaffirmed that shippers have broad discretion in configuring a SARR.⁵ WFA/Basin have exercised these broad rights in a very conservative manner in this case.

The LRR, like all SARRs, is constructed to provide origin-to-destination service for the issue traffic. Here, WFA/Basin's issue traffic moves from the PRB to the LRS. The LRR route of movement mimics BNSF's current route of movement for the LRS traffic.⁶ The LRR traffic group also contains non-LRS traffic. WFA/Basin's non-issue traffic group members consist solely of BNSF utility coal customers that currently, or will soon, utilize the BNSF lines the LRR replaces.⁷ And, WFA/Basin route this traffic

⁵ See, e.g., WTU, 1 S.T.B. at 655 (“[t]o make an SAC presentation, a shipper designs a hypothetical new carrier (a stand-alone railroad, or SARR) that is specifically tailored to serve an optimum traffic group with the optimum physical plant (rail system) needed for that traffic”); WPL I at 12 n.20 (“[u]sing computer models to simulate the flow of traffic over the defendant’s rail system, the complainant can select a traffic group and route system for the SARR that would have sufficient economies of density to maximize revenues while minimizing costs”); APL, 3 I.C.C.2d at 773 (“*SAC Traffic Base – Grouping*. Grouping refers to the inclusion of non-issue traffic in the traffic base that is hypothesized for the SAC system. Grouping is important in estimating SAC because the railroad industry is characterized by economies of density and scope.”)

⁶ See WFA/Basin Op. Narr. at III-B-1.

⁷ Id. at III-A-4.

in the same fashion BNSF does today.⁸ This is as simple, and conservative, as one can get in designing a SARR.

Significantly, the WFA/Basin traffic group contains no rerouted traffic – i.e. traffic that moves using different routings than those currently employed by BNSF. The WFA/Basin traffic group also includes no PRB customers for whom the UP now originates coal traffic. Excluding re-routed, and UP-originated, traffic significantly reduces the LRR traffic volumes – and most likely increases the resulting SAC rates.

WFA/Basin undertake a conservative approach to their traffic group selection because of their need to expedite resolution of this case. WFA/Basin's customers are paying exorbitant freight rates and need prompt rate relief. The Board's consideration of traffic re-route issues,⁹ and reconsideration of its rulings on inclusion of non-defendant carrier traffic in a SARR traffic group,¹⁰ would likely extend the case schedule ad infinitum.

In any case, WFA/Basin cannot credibly be accused of “gaming” the traffic selection for the LRR where, as here, WFA/Basin's LRR traffic group was so conservatively selected.

⁸ Id. at III-A-5.

⁹ See Western Fuels Association, Inc. and Basin Electric Power Cooperative v. BNSF Ry., STB Docket No. 42088 (STB served March 14, 2005) at 2-3.

¹⁰ See AEPCO (STB served Nov. 19, 2003) at 3-4.

**b. Use of Cross-Over Traffic
 is Permitted and Encouraged**

BNSF repeats the same tired arguments it has raised before, and the Board has consistently rejected, concerning the inclusion of SARR cross-over traffic – i.e., traffic that the SARR interchanges with the residual incumbent. According to BNSF, inclusion of cross-over traffic in a SARR is a “gaming” strategy.¹¹ However, as the ICC, and the Board have repeatedly held, inclusion of cross-over traffic is a perfectly permissible form of SARR traffic grouping.¹²

As the Board explained recently in Xcel I, “the Board has accepted extensive use of cross-over traffic in previous cases.” Id. at 13. Inclusion of cross-over traffic permits the SARR “to take into account the economies of scale, scope and density that the defendant carrier enjoys over the routes replicated.” Id. at 13-14. Indeed, if the Board did not permit cross-over traffic, the SAC standard would not work. In the absence of cross-over traffic, a shipper would have two choices: exclude the traffic or include the traffic but eliminate its cross-over status.¹³ The Board has recognized that neither approach is consistent with basic SAC principles.¹⁴

¹¹ See BNSF Reply Narr. at III.A-15.

¹² See Xcel I at 13-17; Xcel II at 7; Duke/NS I at 29; Nevada Power II, 10 I.C.C.2d at 265-67.

¹³ Cross-over traffic is eliminated if the SARR is extended to reach the traffic destination, or interchange point, on the defendant carrier’s lines.

¹⁴ See Xcel I at 13-17.

If a shipper is forced to exclude cross-over traffic, the shipper is denied the scale, scope and density benefits of grouping guaranteed by the Guidelines.¹⁵ Application of such a rule in the instant case would mean that the LRR would have only one shipper and only one movement – WFA/Basin’s PRB-to-LRS traffic. Under this scenario, WFA/Basin would have to build a 188 mile SARR¹⁶ from the PRB to LRS, financed solely by BNSF’s LRS rates. Obviously, a 188 mile single-shipper SARR is not economically feasible.

The other alternative – forced expansion of SARR’s to eliminate cross-over traffic – also directly conflicts with the basic SAC principles. As discussed above, the Guidelines give a shipper broad traffic grouping rights. These broad grouping rights include the right to design a SARR that utilizes the same “production technique[s]”¹⁷ as the incumbent carrier. These production techniques include the right of a SARR to construct its own facilities to provide its customers with origin-to-destination service or to construct a portion of the origin-to-destination facilities and enter into interline arrangements with connecting carriers to complete the service.

¹⁵ Id. at 13-14.

¹⁶ See WFA/Basin Rebuttal electronic workpaper “LRR Route Miles Rebuttal.xls.”

¹⁷ Guidelines, 1 I.C.C.2d at 528 (internal quotation omitted); see also Nevada Power I, 6 I.C.C. 2d at 45.

Thus, under the SAC test “a rail captive shipper is not required to pay more than would be necessary to replicate the rail service it needs for its own traffic.”¹⁸ A captive shipper is not required to replicate facilities it does not use. As the ICC held in Nevada Power II:

in designing a stand-alone railroad (SARR), it may be assumed that existing single-line traffic would become interline traffic that is passed on at hypothetical interchange points. Permitting this assumption and thus crediting a SARR with so-called “cross-over traffic,” will allow shippers to make effective cases before the Commission using smaller hypothetical SARRs than would otherwise be required. Viewing a SARR’s interline rail partners simply as additional customers of the SARR means that the captive shipper is not required to ensure that far-flung rail lines are earning their full replacement cost of capital.

10 I.C.C.2d at 280 (Chairman McDonald commenting).

Expanding the scope of a SARR by including all cross-over traffic origin-to-destination/interchange routings also would create modeling complications and costs of monstrous proportions. For example, in the recent Xcel case, PSCo challenged BNSF’s rates from the PRB to PSCo’s Pawnee generating station in Colorado. 35 of the 37 PSCo SARR movements were cross-over movements.¹⁹ The Board found in Xcel I

¹⁸ McCarty Farms (ICC served Feb. 13, 1995), 1995 WL 55409 at *7 (emphasis added).

¹⁹ See Xcel I at 13.

that if the PSCo SARR were to provide origin-to-destination service for all of its traffic, the resulting SARR would be “at least 10 times larger” in length than the PSCo SARR.²⁰ The Board went on to hold that the resulting SARR could be even more unwieldy if PSCo decided to include other traffic moving over parts of the expanded system (which would require further expansion of the SARR to avoid the creation of new cross-over traffic). This modeling exercise, the Board correctly concluded, would produce “cascading” SARR lines and eventually require the SARR to “replicate almost all of BNSF’s system.”²¹ The Board also correctly found that such a spider-web modeling exercise would “exponentially” expand the scope and complexities of the SAC modeling exercise to the point where the entire process becomes “intractable.”²²

The Board’s findings in Xcel I apply equally in the instant case. As shown in WFA/Basin Rebuttal Exhibit III-A-1, if WFA/Basin were required to model a SARR with its current traffic group that provided origin-to-destination service for all traffic group members, its SARR railroad would be more than 37 times longer than the LRR. And the system would be substantially greater if WFA/Basin included other traffic moving over the expanded system. The results are the same as the results the Board identified in Xcel I – a “cascading” SARR that eventually would be forced to “replicate

²⁰ Id. at 14.

²¹ Id. at 15-16.

²² Id. at 16.

almost all of BNSF's system."²³ Here, as in Xcel, the cost and complexities of modeling a SARR that replicates BNSF's system would lead to "intractable" problems, and, in any event, be prohibitively expensive.

**c. The LRR Contains Short-Haul
Traffic Because it is a Short-Haul Carrier**

BNSF lathers its reply with repeated references to the alleged evils of "short-haul" traffic. BNSF argues that WFA/Basin are "gaming" the system because WFA/Basin include "short-haul" traffic in the LRR.²⁴ BNSF's position is foolish in this case.

The LRR is modeled to follow the current BNSF route of movement for WFA/Basin trains moving from the PRB to LRS. The route mileages on the LRR for the longest of these hauls is 183 miles, and in 4Q04, the average length of the LRS haul was 171.2 miles.²⁵ The LRR route miles are short when compared to the BNSF average coal haul lengths – which approximate 922.1 miles.²⁶ However, this is not the product of any "gaming" by LRS. The LRR movement miles are shorter than the BNSF system-average coal movement miles because the LRS route miles are shorter than the BNSF system-average miles.

²³ Id. at 15-16.

²⁴ See BNSF Reply Narr. at III.A-5.

²⁵ See WFA/Basin Op. Narr. at III-B-3 to 4.

²⁶ See WFA/Basin Rebuttal Workpapers, p. 00167.

Similarly, the LRR cross-over traffic miles (which average 71.1 miles) are short when compared to BNSF's system-average miles. Again, this is not the result of "gaming" but geography. The LRR traffic routes for cross-over traffic mirror the current actual BNSF routes. For example, BNSF currently originates traffic at the Eagle Butte mine and transports that traffic out of the PRB via an Eagle Butte-Donkey Creek-Alliance routing. WFA/Basin included in their SARR only the Eagle Butte-to-Donkey Creek movement miles (approximately 16.6 miles).²⁷ WFA/Basin did not expand their SARR to include the Donkey Creek-to-Alliance segment because the LRS trains do not utilize those lines.

Finally, the average length of LRR cross-over moves (71.1 miles) constitutes 32.6% of the LRR's total route miles.²⁸ This percentage is not out of the ordinary. For example, in TMPA, the average length of cross-over moves constituted 31% of the total SARR route miles.²⁹ Similarly, the shortest LRR movements (9.5 miles) approximate 5.1% of the total LRR route miles (188 miles).³⁰ Other Board-approved SARRs have had far shorter routings when measured against total SARR route miles. For

²⁷ See WFA/Basin Rebuttal electronic workpaper "LRR Route Miles Rebuttal.xls."

²⁸ Id.

²⁹ See WFA/Basin Rebuttal electronic workpaper "TMPA Crossover.xls."

³⁰ See WFA/Basin Rebuttal electronic workpaper "LRR Route Miles Rebuttal.xls."

example, in TMPA, the shortest cross-over traffic route (10.8 miles) constituted 0.7% of the total TMPA SARR route miles.³¹

d. Traffic Group/Divisions Interplay

BNSF repeatedly argues that WFA/Basin are “gaming” the SAC process because, it opines, the LRR earns excessive revenues on its cross-over traffic.³² BNSF’s premise is wrong. As discussed in Part III-A-3 below, the LRR revenue divisions are also calculated in a very conservative fashion.

Moreover, as discussed in Part III-H-3-c below, the margins that so trouble BNSF (i.e. the positive differential between SAC revenues and SAC costs on short haul moves) play no role in WFA/Basin’s RAM procedure for setting maximum rates. RAM-set rates, unlike percentage reduction-set rates, are not based on a procedure that reduces the SARR traffic group members’ rates by the percentage differential between SARR revenues and SARR costs. Instead, RAM utilizes a cost-based approach where LRR traffic members pay their attributable costs and captive shippers in the LRR traffic group pay a pro-rata share of the LRR’s non-attributable costs. Thus, RAM solves BNSF’s asserted “gaming” contentions.³³

³¹ See WFA/Basin Rebuttal electronic workpaper “TMPA Crossover.xls.”

³² See BNSF Reply Narr. at III.A-33.

³³ See Part III-H-3-c below.

Finally, lest there be any doubt about the matter, fundamental SAC principles hold that a shipper should model a “least cost” SARR that maximizes carriage of profitable traffic.³⁴ As repeatedly emphasized by the ICC and the STB:

[t]he design of the SAC system should minimize construction or acquisition, operating and maintenance costs and/or maximize the carriage of profitable traffic.^[35]

2. Volumes

On Reply, BNSF offers two SARR volume forecasts. In the first, BNSF does not “exclud[e]” any O/D shipper pairs.³⁶ BNSF refers to this forecast as its “Full SARR” forecast. Under this Full SARR volume forecast, BNSF calculates that the LRR will ship approximately 4.24 billion tons over the DCF period between the LRR O/D pair – i.e., approximately 59 million tons less than the tonnages WFA/Basin calculate.³⁷ BNSF also includes a second volume forecast that excludes certain LRR O/D volumes. BNSF refers to this forecast as its “cross-subsidy” adjusted volume forecast.³⁸

³⁴ See Guidelines, 1 I.C.C.2d at 543.

³⁵ Coal Trading (ICC decided Oct. 24, 1988) 1988 WL 225021 at *14; accord McCarty Farms (ICC decided Feb. 5, 1988), 1988 WL 225826 at *6 (“profitable traffic should be included in the group to lower the average cost of operation”).

³⁶ See BNSF Reply Narr. at III.A-5.

³⁷ See BNSF Reply electronic workpaper “LRR Traffic and Revenues_WFA Basin Opening_BNSF Revised.xls.”

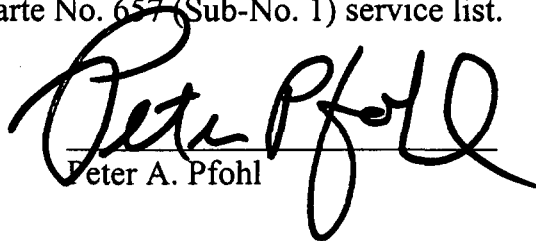
³⁸ Id.

CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of June, 2006, I caused a copy of the foregoing Rebuttal Comments to be served by hand delivery on counsel for BNSF, as follows:

Samuel M. Sipe, Jr.
Anthony J. LaRocca
David F. Rifkind
Steptoe & Johnson, L.L.P.
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036-1795

I also caused copies of these Rebuttal Comments to be served by U.S. First Class mail on all other parties on the Board's Ex Parte No. 657 (Sub-No. 1) service list.


Peter A. Pfohl