

217053

BEFORE THE
SURFACE TRANSPORTATION BOARD



AEP TEXAS NORTH COMPANY

Complainant,

v.

Docket No. 41191 (Sub-No. 1)

BNSF RAILWAY COMPANY

Defendant.

REBUTTAL SECOND SUPPLEMENTAL EVIDENCE OF
COMPLAINANT AEP TEXAS NORTH COMPANY
IN RESPONSE TO MARCH 17, 2006 COMPLIANCE ORDER

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Dated: July 14, 2006

ENTERED
Office of Proceedings
JUL 14 2006
Part of
Public Record

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IN RESPONSE TO MARCH 17, 2006 COMPLIANCE ORDER**

Complainant, AEP Texas North Company ("AEP Texas"), hereby submits its Rebuttal Second Supplemental Evidence ("RSS") in compliance with the Board's Decision served March 17, 2006 ("*Compliance Order*").

I. INTRODUCTION AND SUMMARY

Consistent with the Board's *Compliance Order*, in its Opening Second Supplemental Evidence ("OSS") filed May 15, 2006, AEP Texas modified certain traffic and revenue calculations and RTC Model simulation inputs that had been included in earlier evidentiary submissions. In its June 15, 2006 Reply Supplemental filing, BNSF largely accepted the adjustments made by AEP Texas. However, BNSF also raised a variety of new and old arguments that the Board should reject.

Key among BNSF's concessions is its acceptance of AEP Texas' OSS RTC simulation. As a result, both parties are using the same basic configuration for the SARR – the Texas and Northern Railroad ("TNR"). In addition, both parties are using the same train transit times to determine relevant operating statistics. To be sure, the parties still have significant disagreements on equipment and personnel requirements, but at least the fundamentals of the TNR operating plan, as revised in accordance with the *Compliance Order*, are not in dispute.

The foregoing notwithstanding, BNSF raises new disputes with respect to, *inter alia*, rerouted cross-over traffic; additional locomotives and personnel; and the applicable cost of capital. AEP Texas refutes BNSF's latest claims below.

II. CHANGES TO THE STAND-ALONE TRAFFIC GROUP

In its OSS evidence, AEP Texas made a series of changes to its stand-alone traffic group and related stand-alone cost ("SAC") elements as required by the Board's *Compliance Order*. BNSF accepted, without debate, most of those changes, including:

- Updating the Energy Information Administration ("EIA") Annual Energy Outlook ("AEO") forecasts for the period 2009-2020;
- Adjusting the tonnage levels for Holcomb Unit 2;
- Adjusting the tonnage levels for Springerville; and

- Adjusting the tonnage levels for the Coletto Creek trackage rights traffic.¹

BNSF did not dispute AEP Texas' calculation of the related revenue adjustments using the methodologies endorsed by the Board in prior cases (*e.g.*, the MSP divisions formula) and followed by AEP Texas in its prior submissions. However, BNSF continues to advocate the calculation of SARR revenues using the alternative methodologies that it employed in its Reply Evidence filed on May 24, 2004. *See* BNSF Reply Supp. at 3-5. In its prior evidentiary filings and brief, AEP Texas showed why BNSF's approaches should not be followed, and those reasons need not be repeated here. Nevertheless, there are two areas where BNSF has raised new objections to AEP Texas' stand-alone traffic volumes or revenues. First, BNSF suggests that inclusion of the rerouted traffic from the southernmost PRB mines now represents an impermissible cross-subsidy under the Board's *PPL*² and *Otter Tail*³ cross-subsidy tests. *Id.* at 4. Second, BNSF argues that AEP Texas' calculations of SARR revenues from the Coletto Creek traffic are distorted. *Id.* at 6-7. Neither claim has merit.

¹ BNSF continues to protest the inclusion of Coletto Creek traffic in its entirety, even though it agrees that AEP Texas adjusted the tonnage in accordance with the Board's *Compliance Order*. *See* BNSF Reply Supp. at 6.

² *PPL Mont., LLC v. Burlington N. and Santa Fe Ry. Co.*, 6 S.T.B. 286, 293-296 (2002).

³ Docket No. 42071, *Otter Tail Power Co. v. BNSF Ry. Co.*, Decision served Jan. 27, 2006 at 23-25.

1. **Rerouted Traffic is Not Cross-subsidizing the SARR**

In a brief paragraph, BNSF raises objections, new and old, to the Board's inclusion in the TNR traffic group of the traffic that AEP Texas rerouted from the southernmost PRB mines (Antelope, North/Antelope Rochelle, and North Rochelle). *Id.* at 3-4. Among BNSF's previous claims was that the traffic does not meet the test for inclusion as established in the *Duke/NS*⁴ and *Xcel*⁵ decisions. *See* BNSF Reply Supp. at 3-4. However, AEP Texas repeatedly has shown that this traffic in fact meets the Board's requirements for rerouting, and properly is included in the TNR group.⁶ In particular, AEP Texas demonstrated that the traffic interchanged with BNSF would enter the BNSF system at a point located on the customary route of movement, and that the TNR would handle the traffic over the entire rerouted portion of the movement.⁷ Thus, no costs associated with the rerouting would be shifted to BNSF. Likewise, AEP Texas

⁴ Docket No. 42069, *Duke Energy Corp. v. Norfolk S. Ry. Co.*, Decision served Nov. 6, 2003, at 25-26.

⁵ Docket No. 42057, *Public Serv. Co. of Colo. d/b/a/ Xcel Energy v. BNSF Ry. Co.*, Decision served June 8, 2004, at 19-23.

⁶ *See* AEP Texas Op. Narr., filed March 1, 2004, at III-A-11-13; AEP Texas Rebut. Narr., filed July 27, 2004, at III-A-17-26.

⁷ *See* AEP Texas Op. Narr. at III-A-11-13.

demonstrated that despite some longer hauls, the quality and priority of service on the TNR would meet or exceed that offered by BNSF.⁸

BNSF next suggests, for the first time, that the rerouted traffic “undermines the SAC test as a test for cross-subsidy,” because in the *real world* (before rerouting) this traffic would share little of the SARR’s facilities. *See* BNSF Reply Supp. at 4. BNSF therefore argues that the Board “needs to be vigilant in excluding rerouted traffic that does not meet the standards governing rerouted traffic.” *Id.* BNSF’s arguments are somewhat muddled, and wholly without merit.

BNSF may be arguing that even if the proposed rerouting meets the Board’s *Duke/NS* test, an impermissible “cross-subsidy” still can arise if in the real world the rerouted traffic only shares a small part of the TNR’s facilities. *Id.* at 4.⁹ However, this claim flies in the face of the Board-endorsed purpose of rerouting traffic in the first place: to generate efficiencies and economies (including in particular economies of density) superior to those experienced by the incumbent. *See, e.g., Duke/NS* at 26. The rather obvious fact that rerouted traffic may not share many facilities with a SARR in the *real*

⁸ *See, e.g.,* Table III-C-6 of AEP Texas’ OSS filing at 19, showing the superiority of the TNR’s transit times over the real world transit times on the customary route of movement.

⁹ To the extent that BNSF is claiming that a reroute which fails the *Duke/NS* test also gives rise to an improper cross-subsidy, its reasoning is redundant. If a proposed reroute does not pass the *Duke/NS* test – which the reroutes at issue here clearly do – the traffic will be excluded anyway; a cross-subsidy analysis would be unnecessary.

world is irrelevant to the question of an impermissible cross-subsidy. While AEP Texas does not endorse the *PPL* test as consistent with the mandate of the *Coal Rate Guidelines*, it nevertheless is clear that if that test is applied, the proper focus is whether and to what extent the traffic *as rerouted* shares facilities with the SARR. *See Otter Tail* at 8-10. In this case, the rerouted PRB traffic shares the TNR's facilities with the issue traffic for the whole of the reroute to Alliance.¹⁰ Likewise, the rerouted traffic shares in the expenses and investment of the issue traffic route in proportion with its use of the TNR – the same as any other cross-over traffic. There is no legitimate cross-subsidy issue raised by the reroutes in this case.¹¹

Finally, BNSF wrongly argues, as it has before without success,¹² that because the inclusion of cross-over traffic is only supposed to simplify the SAC presentation, it should not be allowed to have a favorable effect on a shipper's SAC results. *See BNSF Reply Supp.* at 4. The simplification process contemplated by the Board does not prohibit the inclusion of rerouted traffic, and as noted *supra*, its inclusion

¹⁰ The small piece of the TNR that the issue traffic does not *currently* use on the southern end of the SARR in the PRB nearest the southernmost mines is not of concern, because the common carrier pricing authority at issue here covers those mines. AEP Texas could use one of the mines where the rerouted traffic originates at any time.

¹¹ *See also Xcel* at 22, where the Board held that BNSF's approach to limiting rerouted traffic where such traffic does not usually move over a particular route is at odds with the *Guidelines'* respect for the freedom to increase economies of density.

¹² *Otter Tail* at 11-13; *Xcel* at 13-16

as a means to enhance the efficiencies – and thus lower the costs – of the SARR specifically has been endorsed by the agency. *Xcel* at 22; *Duke/NS* at 30.

2. **Changes in Coletto Creek Trackage Rights Fees**

The Board's *Compliance Order* directed the parties to make certain modifications to the gross tonnages for empty and loaded Coletto Creek trains. *Id.* at 2. AEP Texas made the requested changes, which BNSF does not dispute. *See* BNSF Reply Supp. at 3. Likewise, the parties were instructed to recalculate the Coletto Creek trackage rights fees in accordance with the volume changes. *Compliance Order* at 2. Here too, BNSF admits that AEP Texas followed the Board's instructions. Nevertheless, BNSF complains that AEP Texas distorted the trackage rights fees that the SARR would collect. *See* BNSF Reply Supp. at 5-6.

At the heart of BNSF's complaint is the rather unremarkable fact that under the agreement that governs these movements, the trackage rights fees are calculated on a dollars per gross ton-mile basis, and, therefore are greater for loaded trains than for empty trains. Naturally, the TNR would receive most of those fees, because it handles the Coletto Creek trains in the loaded direction. Not satisfied with this outcome – which solely is the product of the evidence of record – BNSF argues that the Board should rewrite the trackage rights fee agreement so that the fee is based on train-miles rather than gross ton-miles. *Id.* at 6-7. The Board should decline BNSF's invitation.

AEP Texas has not distorted the calculation of trackage rights fees under the terms of the trackage rights agreement¹³—a fact that BNSF basically admits. *See* BNSF Reply Supp. at 5. BNSF’s attempted rewrite of the trackage rights fee structure on the basis of train-miles rather than gross ton-miles is wholly arbitrary, and would be made without the consent of the other party to the trackage rights agreement. Such revisionism is without support in the *Guidelines* or SAC procedures. Consequently, AEP Texas has continued to use the trackage rights fees calculation it developed in its OSS evidence.

3. Updating RCAF Data

In its OSS filing, AEP Texas updated the historical Rail Cost Adjustment Factor (“RCAF”) data used to index operating costs, but did not make the same adjustments to its calculation of actual or projected rail transportation rates. *See* BNSF Reply Supp. at 7. AEP Texas also did not incorporate the latest RCAF forecasts in its projections for future time periods. *Id.* AEP Texas agrees that these updates are appropriate, and has made the necessary changes in this RSS filing. The revised TNR revenue results are shown in Table 1 below.

¹³ *See* AEP Texas Op. Narr. at III-A-41-42 for an explanation of the trackage rights fee agreement.

TABLE 1 TNR Revenues – Coal and General Freight				
	Year	AEP Texas Opening Second Supplemental^{1/}	AEP Texas Rebuttal Second Supplemental^{2/}	Difference^{3/}
1.	2000 ^{4/}	\$ 407,219,528	\$ 407,219,528	\$ 0
2.	2001	763,269,738	763,269,738	0
3.	2002	764,526,347	764,526,347	0
4.	2003	740,093,596	740,093,596	0
5.	2004	770,596,329	771,331,592	736,263
6.	2005	761,565,874	774,258,841	12,692,967
7.	2006	782,452,091	803,125,509	19,673,417
8.	2007	808,601,186	827,235,507	18,634,321
9.	2008	820,448,004	835,978,100	15,530,095
10.	2009	848,896,375	863,746,376	14,850,001
11.	2010	862,588,061	876,723,512	14,135,450
12.	2011	891,421,064	904,842,808	13,421,745
13.	2012	941,786,167	952,413,818	10,627,651
14.	2013	967,044,243	977,962,075	10,917,832
15.	2014	988,000,981	999,159,996	11,159,016
16.	2015	1,000,925,417	1,012,224,824	11,299,407
17.	2016	1,027,815,213	1,039,431,209	11,615,996
18.	2017	1,061,781,088	1,073,768,325	11,987,237
19.	2018	1,096,473,575	1,108,852,751	12,379,176
20.	2019	1,132,203,223	1,145,003,863	12,800,639
21.	2020	<u>1,185,565,757</u>	<u>1,199,080,313</u>	<u>13,514,557</u>
22.	TOTAL	18,623,273,857	18,839,248,628	215,974,771

^{1/} From OSS electronic workpaper "Exhibit III-H-3 SPS.xls"
^{2/} From RSS electronic workpaper "Exhibit III-H-3 SPS.xls"
^{3/} AEP Texas Rebuttal Second Supplemental minus AEP Texas Opening Second Supplemental
^{4/} June 16 - December 31

III. RTC SIMULATION AND RESULTS

The *Compliance Order* directed the parties to model the operations of the TNR based on a revised set of assumptions that AEP Texas incorporated into its OSS RTC simulation. *Id.* at 2-3. BNSF accepted the results of AEP Texas' revised RTC simulation. *See* BNSF Reply Supp. at 10. However, as explained below, there are certain configuration and operating cost items that remain at issue.

1. TNR Configuration

In accepting AEP Texas' RTC modeling, BNSF also accepted AEP Texas' configuration of the TNR's mainline and yard track. *See* BNSF Reply Supp. at 9. However, BNSF made certain changes in the Alliance Yard that are unexplained and should be rejected by the Board.

BNSF added 6.3 miles of storage tracks to the yard. These tracks are the same lengths as those that BNSF used on Reply. The problem with BNSF's approach is twofold. First, BNSF's Reply configuration of the Alliance East portion of the yard placed half of the spare tracks directly where BNSF has now added inspection tracks.¹⁴

¹⁴ AEP Texas' design of the Alliance East Yard had 10 inspection tracks on the
(continued...)

Thus, BNSF has not explained where half of its proposed spare tracks even would be located.¹⁵ Second, AEP Texas already provided ample storage space, including several unused 1.5 mile long inspection tracks and a variety of storage areas around the car repair shop.¹⁶ BNSF's additional tracks are neither adequately explained nor needed.

The parties also remain apart on certain minor elements of the TNR's configuration, such as the length of set-out tracks. These differences are discussed in detail in AEP Texas' prior filings.¹⁷ Finally, BNSF included 3.04 fewer track miles for other main and side tracks.¹⁸ Again, this difference is unexplained, so AEP Texas has continued to use its configuration from the OSS submission.

¹⁴(...continued)

south side of the mainlines. On Reply, BNSF effectively shortened three (3) inspection tracks, relabeled them storage tracks, and added one (1) tangent storage track. *See* BNSF Reply Exhibit III.B-1 and BNSF Reply electronic workpaper "Alliance Yard BNSF Reply.pdf" at 1. By accepting AEP Texas' yard configuration, the storage tracks revert to the longer inspection tracks, which were spaced on 25-foot track centers. Therefore, the space the four (4) storage tracks previously occupied reverts to inspection track space in AEP Texas' design of the Alliance Yard.

¹⁵ BNSF states that it has included revised track charts in its Reply Supplemental filing, but appears to have omitted them from its electronic workpapers. *See* BNSF Reply Supp. at 9 n.12.

¹⁶ *See* AEP Texas Reb. Exhibit III-B-6 at pp. 6-8.

¹⁷ *See* AEP Texas Reb. Narr. at III-B-26-27, 30-34.

¹⁸ *Compare* the figures in BNSF Supp. Reply electronic Workpaper "III F 2 TNR Grading - 6-15-06 Reply.xls," tab "III F Miles," Columns "Other Main" and "Side Tracks" (total 497.0 miles) to the figures in AEP Texas Supp. Reb. electronic workpaper "TNR Grading Rebuttal.xls," tab "III F Miles," Columns "Other Main" and "Side Tracks" (totaling 500.04 miles).

2. Changes to Operating Results

Consistent with its practice to date, in its OSS filing AEP Texas utilized its RTC simulation transit times to develop TNR operating statistics for the peak week of the peak year, which then are extrapolated for the entire peak year. The peak year statistics then are adjusted downward to account for the reduced levels of traffic from the base year forward. AEP Texas has done the same in its RSS evidence.

BNSF likewise developed operating statistics in its Reply Supplemental filing consistent with the methods that it used in its original Reply evidence (*see* BNSF Reply Supp. at 10), though it did utilize AEP Texas' OSS RTC simulation transit times in the calculation of operating statistics. *Id.* Nevertheless, the parties remain far apart on some equipment requirements due to their differences in methodology (*i.e.*, AEP Texas used the peak week to determine locomotive requirements whereas BNSF improperly used its peak annual statistics plus a peaking factor).

One new item that BNSF does not explain is its addition of 18 SD40-2 helper locomotives.¹⁹ To this point, the parties had agreed on the number of helpers required for road operations: 42. These helpers operate in places such as Crawford, NE. BNSF now has upped its count to 60 (73 total, including SD40-2s used for other

¹⁹ The parties also use SD40-2s for switching and other purposes. The parties margin of six (6) – AEP Texas had seven (7) additional units and BNSF had thirteen (13) – remains the same.

purposes). Since BNSF accepted AEP Texas' RTC simulation and the helper requirements that flow from the simulation, its unexplained addition should be rejected.²⁰

BNSF also noted an error in AEP Texas' car hours calculation. *See* OSS electronic workpaper "TNR Operating Statistics--Supp Open.xls," tab "Car Hours." AEP Texas has corrected this error and updated the total railroad-owned car count accordingly. *See* RSS electronic workpapers "TNR Operating Statistics--Supp Reb.xls," tab "Car Hours" and "TNR Car Costs_Rebut.xls," tab "Coal Cars." Other than the car hour and car count change, AEP Texas continues to use the operating statistics that it developed in its OSS filing.

IV. OPERATING EXPENSES

In its OSS filing, AEP Texas updated the TNR's operating expenses to reflect changes in crew counts, locomotives, and related cost categories. AEP Texas made no changes to other staffing and costs. BNSF's Reply Supplemental filing largely tracks the approach taken by AEP Texas, except that BNSF uses its own counts and unit costs in some areas (*e.g.*, its locomotive lease expenses are driven by its count of

²⁰ The count of SD40-2s is based on the constant stationing of the units at the helper locations. The total count was based on the number of trains that would require help at a particular point, and the timing of such help was based on the RTC modeling. A spare margin also was applied.

locomotives).²¹ In those areas where BNSF simply updated its Reply costs to reflect changes in traffic or infrastructure, AEP Texas agrees that BNSF updated those costs appropriately.²² However, for the reasons explained in detail in AEP Texas' July 27, 2004 Rebuttal Evidence, many of BNSF's operating expense assumptions and unit costs are unfounded and/or unsupported. As to these components, AEP Texas refers the Board to its operating expense evidence previously submitted as the best evidence of record. Finally, BNSF has made several new changes that are unwarranted or unexplained, which are addressed further below and likewise should be rejected.

1. **Locomotive Fuel Expenses**

In its *Compliance Order*, the Board directed the parties to model the TNR's operations on the assumption that trains moving south of Pueblo on the TNR would be fueled at AEP Texas' Las Animas Yard, rather than BNSF's proposed yard in Amarillo. *Id.* at 3. While BNSF generally followed the Board's direction, it made two adjustments to the associated fuel expenses that the Board should reject. First, BNSF applied "its system-average fuel price, before accounting for any benefits or losses from BNSF's fuel hedging program ('pre-hedged')." *See* BNSF Reply Supp. at 12-13. As the least cost,

²¹ BNSF also made certain technical corrections, such as fixing a link in a railcar expense spreadsheet. AEP Texas has no objections to these corrections.

²² Those areas include locomotive lease and maintenance expenses, railcar expenses, operating personnel, and maintenance-of-way. BNSF did not make any changes to its G&A expenses.

most efficient market entrant, the SARR should be presumed to avail itself of the same long-term benefits of hedging that BNSF does. Indeed, assuming that the TNR could not hedge is a barrier to entry. Moreover, in BNSF's original Reply evidence, it used its system-average costs for fueling where it did not have location specific fueling costs.²³ Therefore, BNSF's move to using pre-hedged costs is inappropriate at this time and inconsistent with the Board's admonition not to raise new arguments in this phase. *Compliance Order* at 3. Thus, AEP Texas continues to use BNSF's system-average fuel costs, including any results of hedging, in its fuel expense calculation.

Second, BNSF has added off-SARR fueling expenses for trains fueled at Las Animas, based on the belief that they will require additional fueling on the residual BNSF in order to return to Alliance in the empty direction to be fueled again. *See* BNSF Reply Supp. at 13. BNSF's additional costs are without merit.

In its Rebuttal evidence, AEP Texas' witness Mr. Paul Reistrup provided an extensive explanation of why fueling in Las Animas is superior to fueling in Amarillo. *Id.* at III-B-30-51. He also provided ample evidence that BNSF's concerns about trains running out of fuel were unfounded. *Id.* Moreover, AEP Texas demonstrated that BNSF's expectation that no fueling or inspecting would be conducted off-SARR was inconsistent with its acceptance of AEP Texas' operating plan for most of the cross-over traffic moving east of Alliance, as well as traffic moving south of Pueblo and on to

²³ *See* BNSF Reply electronic workpaper "Total TNR Fuel.xls."

Arizona or Louisiana. *Id.* at III-B-35. Thus, the Board should reject the additional off-SARR fueling costs now proposed by BNSF.

Finally, BNSF changed the fueling costs applied to non-coal trains that move overhead on the TNR between Amarillo and Oklaunion. Consistent with how BNSF handles the traffic in the real world, under AEP Texas' operating plan these trains were fueled off-SARR using BNSF's system-average fuel costs, including hedging. On Reply, BNSF did not object to this method. *Id.* at III-B-42-43 (noting that BNSF did not contest AEP Texas' fueling plan for this traffic). Now, without justification, on Supplemental Reply, BNSF applied its pre-hedged cost of fuel. BNSF's change in position is unwarranted because BNSF is fueling the locomotives on its property where its hedged cost of fuel logically applies. More importantly, BNSF's change is beyond the permissible scope of reply in this proceeding. Therefore, BNSF's system-average fuel costs including hedging should apply to these overhead trains.

2. Operating Personnel Changes

BNSF made two changes to its operating personnel count that the Board should reject. First, BNSF proposed to add two hostler crews (17 employees) and one crew hauler employee, or a total of 18 people, to handle the increased traffic and employee movements in the Alliance Yard when AEP Texas' traffic group is used. *See*

BNSF Reply Supp. at 15. As Mr. Reistrup explained on Rebuttal, hostlers and crew haulers are not needed at all in the Alliance Yard.²⁴

Without explanation, BNSF also added an additional 10 train and engine employees dedicated to helper service. *See* BNSF Reply Supp. electronic workpaper “OPR_EXP.xls,” tab “Summary.” Presumably, BNSF added these employees to work on the additional helper locomotives it added, as discussed *supra*. In any event, as with the helper locomotives, BNSF has presented no rationale for their addition, and the Board should reject them.

V. CHANGES TO ROAD PROPERTY INVESTMENT

Since BNSF adopted AEP Texas’ SARR configuration as determined by the RTC model, it also updated its road property investment costs accordingly.²⁵ BNSF notes two larger cost items in particular in its Supplemental Reply – additions to the Alliance Yard and the Las Animas fueling facilities. As explained *supra*, however, BNSF’s unexplained addition of storage tracks to AEP Texas’s configuration of the Alliance Yard should be rejected. BNSF’s update of the yard configuration is otherwise identical to

²⁴ *See* AEP Texas Reb. Narr. at III-D-37-40.

²⁵ BNSF also made certain technical corrections pointed out by AEP Texas on Rebuttal. These corrections include fixes to: clearing and grubbing; lateral drainage; retaining walls; transition ties; anchors at grade crossings; and bridge inventory. AEP Texas does not dispute these corrections, nor does it dispute BNSF’s inclusion of an omitted crew change facility in Denver.

AEP Texas'. As for the Las Animas fueling facility, BNSF's cost adjustments are consistent with its costing of the Amarillo fueling facility in its Reply evidence. However, as AEP Texas explained on Rebuttal, those costs are overstated. Accordingly, AEP Texas continues to use its costs for the Las Animas fueling facility and the Alliance Yard.

As for its other configuration updates, BNSF used its unit costs and other assumptions when updating its costs. For the reasons explained in detail by AEP Texas on Rebuttal,²⁶ BNSF's assumptions are incorrect. In any event, AEP Texas' road property investment figures have not changed since its First Supplemental filing, and they do not change here. AEP Texas submits that its unit costs, quantities and additives are the best evidence of record, and should be adopted by the Board.

VI. DISCOUNTED CASH FLOW ANALYSIS

In its OSS submission, AEP Texas updated the historical RCR and RCAF indices used to index the capital recovery requirement and operating expenses in the DCF model through 1Q06 and 2Q06, respectively. However, AEP Texas did not update the projections for future years for either of those indices. *See* BNSF Reply Supp. at 20. AEP Texas agrees that the projection of changes in those indices for future periods also should be updated. The DCF results shown below reflect those changes, as well as the RCAF updates discussed *supra*, with respect to the TNR's revenue projections.

²⁶ *See* AEP Texas Reb. Narr., Part III-F.

BNSF also proposes that the Board update the cost of capital calculations to reflect the AAR's proposed cost of capital for 2005, claiming that this is consistent with past practice in SAC cases. *Id.* at 20. In fact, however, BNSF's proposed adjustment is *inconsistent* with Board precedent. The cases, including those relied on by BNSF,²⁷ all make clear that the only updates to the cost of capital that are appropriate are those that reflect the most recent *final* findings adopted by the Board. The Board has never incorporated the AAR's *proposed* cost of capital in the manner suggested by BNSF.

Of course, the Board also is well aware that the AAR's latest cost of capital filings are hotly contested. Indeed, the Western Coal Traffic League ("WCTL") has pointed out that the AAR's proposed figures bizarrely imply that the railroads' composite cost of capital is rising even as the railroads' financial performance and condition are soaring to new heights. See the Reply Comments of the Western Coal Traffic League filed April 28, 2006, in Ex Parte No. 558 (Sub-No. 9), *Railroad Cost of Capital – 2005*, at 3. In an obvious exposure of a fundamental flaw in the AAR's methodology, the organization's submission argues that the railroads' successes (and commensurately lower investment risk) actually are driving the cost of capital higher. *Id.* at 3-5. As WCTL observed:

this . . . certainly becomes arbitrary and capricious, when the cost of capital is used for such purposes as to determine the revenue adequacy of individual railroads, to adjudicate the

²⁷ BNSF's Reply Supp. at 18 n. 26.

reasonableness of the common carrier rates paid on individual movements, to regulate the railroad industry more generally, and to govern various aspects of private rail transportation contracts. The cost of capital should not be allowed to increase just because the railroads have been able to increase their rates, revenues, and earnings. Such developments should make the railroads revenue adequate or at least come significantly closer to achieving that goal, whereas the impact of the AAR's calculations will likely be to make the railroads appear further away from achieving that objective. In other words, the effect of increasing railroad earnings should not be to allow them to charge still higher rates. Such an outcome is the antithesis of meaningful economic rate regulation.

Id. at 5-6.

WCTL's filing demonstrated that AAR's proposed 15.19% cost of equity for 2005 was inconsistent with the recent run-up in railroad stock prices and earnings, and assumed a perpetual growth trend in earnings that was considered unrealistic by an expert retained by the Union Pacific Railroad itself to testify in STB rate cases. WCTL further explained that the cost of equity should not be allowed to increase by 15.4% relative to 2004 simply because the railroads are earning greater revenues and profits, which drives financial analysts' expectations for continued growth in railroad earnings. AEP Texas agrees, and incorporates WCTL's Reply Comments in *Railroad Cost of Capital – 2005* by reference.

Under the circumstances, it would be wholly improper for the Board here to accept a revised cost of capital figure that is not only controversial and demonstrably flawed, but has not been considered or accepted by the Board for general application.

VII. REVISED DCF ANALYSIS

AEP Texas has revised the DCF analyses presented in its OSS filing to reflect the changes in the TNR's revenues, annual operating expenses and related indices as described above.²⁸ The results are shown in RSS electronic workpaper "Exhibit III-H-3 SPS.xls." As was the case with AEP Texas' previous evidentiary submissions, the maximum SAC rates for the Oklahoma coal movement were determined using two alternative methodologies for the allocation of surplus SARR revenues over stand-alone costs: the equalized percentage reduction method employed by the Board in recent rate cases, and AEP Texas' proposed Generalized Percentage Reduction Method (GPRM).

The results for the period from 2Q00 through 1Q04 using GPRM are shown in Column (5) of the revised version of Table III-H-4 from pp. 22 to 23 of AEP Texas' OSS evidence, which is set forth below. The net result is that SAC during the first year of the 20-year DCF period is \$10.56, which is the same as the SAC level reflected in AEP Texas' OSS evidence.

²⁸ No changes to the TNR's capital investments were required.

Table III-H-4
(Rebuttal Second Supplemental Revision)
Summary of Maximum Rate Calculations for Issue Traffic- 2Q00 through 1Q04

<u>Time Period</u> (1)	<u>BNSF Rate</u> <u>Per Ton ^{1/}</u> (2)	<u>BNSF Variable</u> <u>Cost Per Ton ^{2/}</u> (3)	<u>Jurisdictional</u> <u>Threshold Per Ton ^{3/}</u> (4)	<u>Stand-Alone</u> <u>Cost Per Ton ^{4/}</u> (5)	<u>Maximum</u> <u>Rate Per Ton ^{5/}</u> (6)
Buckskin Mine Originations					
2Q00	\$13.68	\$6.53	\$11.75	\$10.56	\$11.75
3Q00	15.78	6.55	11.79	10.26	11.79
4Q00	15.78	6.77	12.19	10.56	12.19
1Q01	15.78	6.96	12.53	10.82	12.53
2Q01	15.78	6.98	12.56	10.82	12.56
3Q01	15.78	7.03	12.65	10.82	12.65
4Q01	15.78	6.92	12.46	10.82	12.46
4Q03	18.04	7.23	13.01	10.27	13.01
Eagle Butte Mine Originations					
1Q03	\$17.25	\$7.31	\$13.16	9.85	\$13.16
2Q03 117 Cars	18.04	6.94	12.49	10.27	12.49
2Q03 128 Cars	18.04	6.88	12.38	10.27	12.38
3Q03	18.04	7.08	12.74	10.27	12.74
4Q03	18.04	7.08	12.74	10.27	12.74
1Q04	18.83	7.16	12.89	10.11	12.89
Jacobs Ranch Mine Originations					
2Q00	\$13.68	\$5.97	\$10.75	10.56	\$10.75
3Q00	15.78	6.33	11.39	10.26	11.39
1Q01	15.78	6.80	12.24	10.82	12.24
2Q01	15.78	6.80	12.24	10.82	12.24
3Q01	15.78	6.66	11.99	10.82	11.99
4Q01	15.78	6.73	12.11	10.82	12.11
1Q02	15.78	6.39	11.50	9.95	11.50
4Q02	17.25	7.28	13.10	9.78	13.10
Black Thunder Mine Originations					
1Q01	\$15.78	\$6.47	\$11.65	10.82	\$11.65
3Q01	15.78	7.01	12.62	10.82	12.62
4Q01	15.78	6.54	11.77	10.82	11.77
2Q02	15.78	6.77	12.19	9.95	12.19
4Q02	17.25	7.29	13.12	9.78	13.12
4Q03	18.04	7.12	12.82	10.27	12.82
1Q04	18.83	7.24	13.03	10.11	13.03
Caballo Rojo Mine Originations					
2Q00	\$13.68	\$6.44	\$11.59	10.56	\$11.59
4Q00	15.78	6.65	11.97	10.56	11.97
1Q01	15.78	6.85	12.33	10.82	12.33
2Q01	15.78	6.69	12.04	10.82	12.04
3Q01	15.78	6.99	12.58	10.82	12.58
4Q01	15.78	7.00	12.60	10.82	12.60
North Antelope Mine Originations					
3Q03	\$18.04	\$7.01	\$12.62	10.27	\$12.62
Caballo Mine Originations					
2Q02	\$15.78	\$7.27	\$13.09	9.95	\$13.09
3Q02	17.25	6.67	12.01	9.78	12.01
4Q02	17.25	7.58	13.64	9.78	13.64

2Q03	18.04	7.28	13.10	10.27	13.10
Cordero Mine Originations					
2Q03	\$18.04	\$6.87	\$12.37	10.27	\$12.37
North Rochelle Mine Originations					
3Q02	\$17.25	\$7.33	\$13.19	9.78	\$13.19
4Q03	18.04	6.72	12.10	10.27	12.10
Antelope Mine Originations					
4Q03	\$18.04	\$5.97	\$10.75	10.27	\$10.75
1Q04	18.83	7.06	12.71	10.11	12.71

- 1/ The Pricing Letters.
- 2/ Rebuttal Exhibit II-A-151.
- 3/ Column (3) x 180 percent.
- 4/ RSS electronic workpaper "Exhibit III-H-3 SPS.xls."
- 5/ Greater of jurisdictional threshold (Column (4)) or stand-alone cost (Column (5)).

VIII. CONCLUSION

AEP Texas' Rebuttal Second Supplemental Evidence again demonstrates the continued feasibility of the TNR's operating plan. The modest revisions to annual operating expenses resulting from the correction in AEP Texas' car hour calculations result in minor changes to the SAC results. Likewise, updating the RCAF and RCR indices result in only minor changes to the SAC results. In total, these results continue to demonstrate the unreasonableness of the common carrier rates charged by BNSF for the movement of PRB coal to AEP Texas' Oklaunion Generating Station, and continue to support the maximum rate relief and reparations sought by AEP Texas.

Respectfully submitted,

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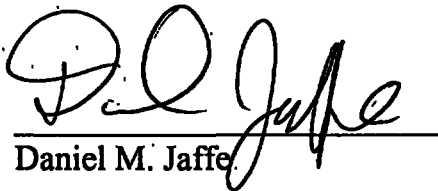
Dated: July 14, 2006

Attorneys & Practitioners

CERTIFICATE OF SERVICE

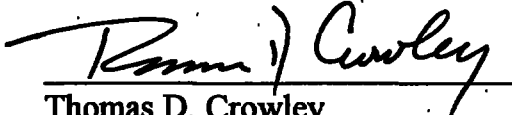
I hereby certify that on this 14th day of July 2006, I caused a copy of the foregoing Rebuttal Second Supplemental Evidence of Complainant AEP Texas North Company to be served by hand delivery on counsel for BNSF, as follows:

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


Daniel M. Jaffe

VERIFICATION

I, Thomas D. Crowley, verify under penalty of perjury that I am the same Thomas D. Crowley whose Statement of Qualifications appears in Part IV of the Narrative portion of the Opening Evidence of Complainant AEP Texas North Co. ("AEP Texas") filed in this proceeding on March 1, 2004; that I am responsible for the portions of the foregoing Rebuttal Second Supplemental Evidence of AEP Texas in Response to March 17, 2006 Compliance Order related to the changes to the SARR traffic group volumes and revenues, the changes in SARR operating expenses (jointly with AEP Texas Witness Philip Burris), and the revised DCF, including the updating of indices; that I know the contents thereof; and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.


Thomas D. Crowley

Executed on: July 14, 2006

VERIFICATION

I, Philip H. Burris, verify under penalty of perjury that I am the same Philip H. Burris whose Statement of Qualifications appears in Part IV of the Narrative portion of the Opening Evidence of Complainant AEP Texas North Co. ("AEP Texas") filed in this proceeding on March 1, 2004; that I am responsible (jointly with AEP Texas Witness Thomas D. Crowley) for the portions of the foregoing Rebuttal Second Supplemental Evidence of AEP Texas in Response to March 17, 2006 Compliance Order related to the changes in SARR operating expenses; that I know the contents thereof; and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.

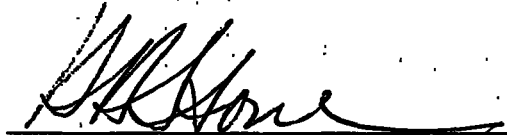


Philip H. Burris

Executed on: July 14, 2006

VERIFICATION

I, Harvey H. Stone, verify under penalty of perjury that I am the same Harvey H. Stone whose Statement of Qualifications appears in Part IV of the Narrative portion of AEP Texas North Company's ("AEP Texas") Opening Evidence in this proceeding; that I am responsible for the portions of the foregoing Rebuttal Second Supplemental Evidence of AEP Texas related to capital costs, the configuration of the Alliance Yard and BNSF's adjustments thereto; that I know the contents thereof; and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.


Harvey H. Stone

Executed on: July 13, 2006.