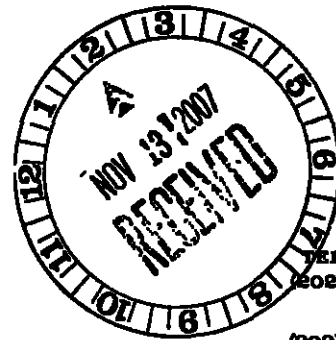


220674

SLOVER & LOFTUS
ATTORNEYS AT LAW
1224 SEVENTEENTH STREET, N.W.
WASHINGTON, D.C. 20036-3003



WILLIAM I SLOVER
C MICHAEL LOFTUS
JOHN H LE SEUM
KELVIN J DOWD
ROBERT D ROSENBERG
CHRISTOPHER A MILIS
FRANK J PERCOLIZZI
ANDREW B KOLESAR III
PETER A PFOHL
DANIEL M JAFFE
STEPHANIE M PISANELLI
JOSHUA M HOFFMAN

OF COUNSEL
DONALD G AVERY

TELEPHONE
(202) 347-7170

FAX
(202) 347-3619

WRITER'S E-MAIL

kjd@sloverandloftus.com

November 13, 2007

VIA HAND DELIVERY

The Honorable Vernon A Williams
Secretary
Surface Transportation Board
395 E Street, SW
Washington, D.C. 20423-0001

ENTERED
Office of Proceedings

NOV 13 2007

Part of
Public Record

Re Docket No. 41191 (Sub-No 1) *AEP Texas*
North Company v BNSF Railway Company

Dear Secretary Williams

Enclosed for filing, in the above-referenced proceeding please find an original and twenty (20) copies of the Complainant's Reply to BNSF Railway Company's Petition for Reconsideration

Please date stamp the extra copy of this cover letter and the enclosed filing, and return them to our messenger. Thank you for your attention to this matter.

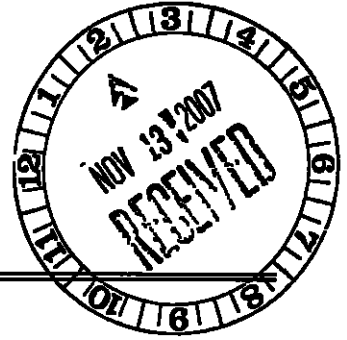
Sincerely,

Kelvin J. Dowd
An Attorney for AEP Texas North Company

Enclosure

cc Counsel for Defendant

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



AEP TEXAS NORTH COMPANY

Complainant,

v.

BNSF RAILWAY COMPANY

Defendant.

Docket No. 41191 (Sub-No. 1)

REPLY TO PETITION FOR RECONSIDERATION

Complainant, AEP Texas North Company ("AEP Texas") hereby replies in opposition to the Petition for Reconsideration of the Board's September 10, 2007 Decision ("*Decision*") filed by Defendant BNSF Railway Company ("BNSF") on October 22, 2007. In its Petition, BNSF objects to the Board's ruling permitting AEP Texas to supplement its SAC evidence in light of the Board's application of its new ATC revenue allocation methodology, and contends that the Board's modification of the ATC methodology was improper. BNSF's arguments lack merit, and should be rejected.

PREFACE AND SUMMARY

BNSF argues that the Board should not have given AEP Texas the option of submitting supplemental SAC evidence in this proceeding for two reasons: (i) the Board's 1996 SAC analysis regarding service from the Rawhide mine supposedly should have precluded *any* consideration of the reasonableness of BNSF's rates in the instant case, and (ii) notwithstanding the Board's adoption of the ATC divisions methodology in the midst of this proceeding, AEP Texas supposedly "had no valid reason" to rely on the Board's historic treatment of revenues from cross-over traffic in seeking relief from the rates at issue. Petition at 2. BNSF is wrong in its characterization of and reliance on the Board's 1996 decision, and BNSF improperly applies the governing standard regarding the submission of new evidence in response to mid-proceeding changes in Board methodology. Even though BNSF's argument likely is moot in light of AEP Texas' election not to submit additional SAC evidence at this time, the Board should take this opportunity to make a clear record on these issues.

BNSF also objects to the Board's decision to modify its ATC methodology, arguing that the Board's "contribution" refinement is inconsistent with the underlying premise and "core justification" for ATC. In effect, BNSF maintains that once the Board stated in *Major Issues*¹ that it favors a divisions methodology that reflects the impact of

¹ *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No.1) (STB served October 30, 2006).

density on the allocation of fixed costs, the Board is forever bound to utilize the most rigid application of that methodology without regard to the consequences. AEP Texas has appealed the Board's adoption of ATC to the D.C. Circuit, *inter alia*, on the ground that its formulaic allocation of what historically have been recognized as unallocable fixed costs is arbitrary. Assuming *arguendo* that the adoption of ATC was defensible, however, upon finding that the impact of ATC (in its unrefined state) is "illogical and unintended" and violates the principle that traffic "must cover its variable cost before it can be expected to make any contribution to joint and common fixed costs" (*Decision* at 15-16), the Board was entirely justified in modifying the approach further. *Id.* at 16. BNSF has no basis for insisting that the Board adhere to a brand new formula that upon first application is found to produce unintended and illogical results that are in conflict with the Board's express purpose.

ARGUMENT

I. The Legal Standard

A party may seek reconsideration of a Board decision by submitting a timely petition that presents new evidence or changed circumstances that would materially affect the case, or demonstrates material error in the prior decision. *See* 49 U.S.C. § 722(c); 49 C.F.R. Part 1115.3. BNSF does not present any argument regarding new evidence or changed circumstances, and relies solely upon claims of material error

As demonstrated below, BNSF has not met the necessary standard of proof in support of its claims of material error. *See, e.g., Albany & Eastern R.R. v. BNSF Ry.*, STB Docket No. 42076 (STB served Nov. 10, 2003), at 2 (finding that the petitioner had failed to demonstrate material error), *PPL Montana, LLC v. BNSF Ry.*, STB Docket No. 42054 (STB served June 30, 2003), at 2; *Sierra Pacific Power Co. and Idaho Power Co. v. Union Pacific R.R.*, STB Docket No. 42012 (STB served April 16, 1998), at 4 (finding that complainants had failed to make an adequate showing of material error).

II. The Board Properly Allowed the Submission of Supplemental SAC Evidence

In the *Decision*, the Board found that in light of its determination to apply the new ATC methodology to a record that was fully assembled before that methodology was even adopted, fairness dictated that AEP Texas should have the opportunity to present supplemental SAC evidence responsive to the Board's move to ATC. *Decision* at 23-24. BNSF challenges this aspect of the *Decision* as materially erroneous for two reasons. Neither is persuasive.

First, BNSF argues that the Board should have dismissed AEP Texas' Complaint without *any* evidentiary submissions, because BNSF never charged AEP Texas a rate above the levels set forth in the Board's 1996 SAC analysis of rates from the Rawhide Mine conducted in *West Texas Utilities*.² Petition at 4-5. BNSF has raised this

² *West Texas Utilities Company v. Burlington Northern Railroad Company*, 1 S.T.B. 638 (1996).

argument a number of times in this proceeding, and its current iteration has no more merit than its predecessors.

The 1996 SAC analysis that BNSF references is now eleven years old,³ and at BNSF's repeated insistence always has formed the basis of a rate prescription for service only from the Rawhide Mine. In its June 7, 2005 Reply to Defendant's Second Motion to Dismiss, AEP Texas explained in detail, supported by ample legal authority, why the 1996 *West Texas Utilities* decision imposed no impediment to a complete review of the reasonableness of the rates at issue here, based upon a full evidentiary record and current Board standards and procedures. In the *Decision*, the Board agreed:

[I]n *West Texas*, and in two subsequent decisions in that docket (served November 7, 2000 and March 23, 2001), the Board explicitly ruled that the prescription in that case applied solely to movements from Rawhide. That stands as the law of this case. The Board's subsequent change of policy in *TMPA Reconsidered* may not be applied retroactively to this case. Moreover, it was BNSF that previously urged the Board to find that the Rawhide prescription was not applicable to the other mines. Thus, BNSF is estopped from arguing the Board erred in adopting the limitation BNSF had requested.

Decision at 4-5 (footnotes omitted). In its Petition, BNSF offers nothing of substance to undercut or even call into question the correctness of the Board's legal reasoning on this issue. Its claim of material error, therefore, must fail. *Albany & Eastern R R*, *supra*

³ The outdated nature of this 1996 analysis is even more evident in light of the Board's decision in *Major Issues* to adopt a ten-year DCF model.

BNSF next asserts that the Board's holding in the *PPL Montana*⁴ case supposedly precludes any submission of supplemental SAC evidence by AEP Texas under the present circumstances. Petition at 5-7.⁵ Sifted of its repetition of the claim that the 1996 *West Texas Utilities* ruling nullifies any justifiable reliance on subsequent changes in either the factual record or the Board's implementation of the *Coal Rate Guidelines*, BNSF's argument boils down to the notion that AEP Texas could not reasonably rely on any established rule or precedent concerning cross-over revenue allocations that the Board later changed, following the submission of AEP Texas' case in chief. *Id.* This argument likewise is without merit.

In *Major Issues*, the Board re-affirmed that the inclusion of cross-over revenue, "which was first accepted by the Board in 1994 in the *Nevada Power* case, is now a well-established practice in SAC cases." *Id.* at 24. Similarly, the Board confirmed that the MSP divisions methodology that AEP Texas had employed was the Board's "current approach." *Id.* at 25. Indeed, some two (2) years earlier the Board argued to the D.C. Circuit that the MSP approach represented a "settled rule" that was entitled to

⁴ *PPL Montana LLC v. BNSF Ry.*, STB Docket No. 42054 (STB served Aug. 20, 2002) ("*PPL Montana*").

⁵ BNSF also attempts a negative analogy to the Board's rulings in *Arizona Electric Power Cooperative, Inc. v. BNSF Ry., Et Al.*, STB Docket No. 42058 (STB served Nov. 18, 2003). The rather unique factual circumstances presented in that case make it wholly inapposite for any purpose relevant to the instant proceeding.

deference and a presumption of regularity,⁶ and the Court of Appeals agreed.⁷ To be sure, the Board often has included in its decisions statements to the effect that it “had not adopted a single preferred procedure” for allocating cross-over revenues. See, e.g., *Duke Energy Corp v Norfolk Southern Ry*, STB Docket No. 42069 (STB served Nov. 6, 2003) at 17 n 27. However, those observations notwithstanding, the indisputable fact is that the Board had applied MSP in the last ten cases in which cross-over revenues were at issue, and as recently as January 2006 (long after the principal record in this case had closed) referred to MSP as a “settled rule.” *Otter Tail Power Company v BNSF Railway Company*, STB Docket No. 42071 (STB served Jan. 27, 2006) at 13.

The foregoing starkly contrasts this case from *PPL Montana*. There, the Board declined to allow the complainant to supplement a closed record in response to the Board’s introduction of an internal cross-subsidy analysis that “merely applied well established principles to the particular facts and issues presented to us in this case.” *Id.* at 7. In the instant case, the “well established” rule was MSP; even though the Board occasionally referred to its open-mindedness as regards alternatives,⁸ it repeatedly invoked and applied that methodology in deciding actual cases. Under these circumstances, the Board’s allowance of supplemental evidence was entirely consistent

⁶ No. 05-1030, *BNSF Railway Company v S T B* (D.C. Cir.), Brief of Respondents, June 21, 2005 at 18, 52.

⁷ *BNSF Railway Company v S T B*, 453 F.3d 473, 483 (D.C. Cir. 2006).

⁸ See Petition at 7-8.

with relevant precedent *See Otter Tail* at 2 (STB served April 14, 2003); *Pub Serv Co of Colorado d/b/a Xcel Energy v BNSF Ry Co*, STB Docket 42057 (STB served February 17, 2004), at 1

Inasmuch as AEP Texas plainly had a reasonable basis for expecting that the MSP approach on which it had based its SARR configuration would (consistent with precedent) continue to be applied by the Board, it was entirely fair and reasonable for the Board to afford AEP Texas the opportunity to submit supplemental evidence following the October 2006 decision in *Major Issues* to adopt ATC. For the reasons articulated in its October 22, 2007 Notification, AEP Texas has declined to submit such evidence at this time, which may render BNSF's arguments moot. To the extent that the Board considers it necessary or appropriate to address them, however, they should be rejected.

III. BNSF Has Not Demonstrated That the Board's Refinement of ATC Constitutes Material Error

BNSF's second allegation of error relates to the Board's finding that when the ATC methodology as adopted in *Major Issues* was applied for the first time to the actual record in this case, it led to "illogical and unintended" results that could not form a proper foundation for the SAC analysis. *Decision* at 15. Specifically, the Board found that as applied by the parties following the directive in *Major Issues*, ATC can generate an on-SARR revenue allocation for certain traffic that "would not be sufficient to cover the variable cost (as calculated using URCS) of handling traffic over the highest-density

portion of the movement ” *Id* Rather than concluding from this fact that the ATC methodology itself must be fundamentally flawed and should be abandoned, the Board determined that it should refine ATC. That refinement involved applying the ATC allocation procedure to the total revenue *contribution* (i.e., the revenue in excess of variable cost as calculated by URCS), instead of to total aggregate revenue *Decision* at 15 Thus, the revenue assigned to the on-SARR portion of a cross-over movement “will include at a minimum the variable cost to haul the traffic over the facilities replicated by the SARR, plus the portion of available contribution to fixed costs allocated in accordance with ATC ” *Id* at 15-16. The Board observed that this refinement was both “reasonable and consistent with [the Board’s] objective in *Major Issues* ” *Id* at 16; *id* (“Traffic must cover its variable cost before it can be expected to make any contribution to joint and common fixed costs ”)

As noted, *supra*, AEP Texas submits that ATC itself is an improper and arbitrary methodology for allocating cross-over revenues, and is seeking review and vacation of the formula in the Court of Appeals Assuming *arguendo* that ATC is a reasonable regulatory tool, however, BNSF’s arguments fail to demonstrate that the Board’s refinements constituted material error

BNSF first contends that the Board’s refinement of ATC is inconsistent with the Board’s own previously stated intentions, and supposedly introduces a bias in favor of cross-over traffic that ATC was designed to eliminate See Petition at 13 (“In all cases, modified ATC systematically disfavors the residual portion of a movement and

reintroduces the bias in favor of a SARR using cross-over traffic that ATC was designed to eliminate "). Essentially arguing that the Board either overlooked what it had hoped to accomplish through the adoption of ATC, or failed to understand that its refinement modifies the original version of ATC, BNSF alleges material error simply because modified ATC produces results that are different from the results obtained through application of unmodified ATC. *Id.* at 12. While the fact that a modified methodology will produce a different result is hardly surprising, BNSF insists that a failure to base cross-over divisions purely on total costs somehow constitutes an abdication of responsibility on the Board's part *Id.*

The Board's discussion of this issue makes clear both that BNSF's perception of the Board's intentions is not correct, and that the Board's modification was the result of a reasoned conclusion that the original version of ATC creates an improper cross-subsidy:

[I]t is the revenue contribution after variable costs have been covered that must be allocated between the facilities replicated by the SARR and those of the residual incumbent. We recognize that the language used in *Major Issues* to explain the basic ATC approach led the parties to allocate total revenues rather than total revenue contribution. However, in that discussion we did not contemplate this situation, where such a procedure would result in other traffic on the SARR having to cross-subsidize those cross-over movements that would result in an on-SARR revenue allocation below variable costs.

Decision at 16.

Presumptuously, BNSF argues that the rigid application of unmodified ATC “accomplishes exactly [what] the Board intended . . .” Petition at 18 (emphasis added). In other words, BNSF claims that the Board *intended* to leave SARRs with insufficient revenue to cover their variable costs. For its part, the Board states that this was an “unintended and illogical” result. Obviously, the Board’s understanding of its own intentions is entitled to greater deference than BNSF’s supposition, and the Board should not be bound to a method that (as BNSF suggests) would force complaining shippers to exclude profitable traffic from their SARR systems. *See PSCO/Xcel* at 7 (STB served Jan. 19, 2005) (finding over BNSF’s objection that “without cross-over traffic, captive shippers could lack a practicable means by which to prosecute rate complaints. Thus, we continue to believe that the value of the evidentiary tool outweighs its limitations.”)

Notably, the modified version of ATC still considers density and fixed costs (albeit fixed costs that have been allocated in an arbitrary manner) in calculating divisions where revenues exceed variable costs. Obviously unable to deny this fact, BNSF concocts examples that purportedly support its argument that modified ATC is improper. *See* Petition at 13-17. BNSF’s examples, however, only demonstrate that as long as the revenues available for a given cross-over movement cover the variable costs of services, then both density and fixed costs will impact the determination of divisions under modified ATC, and lower density off-SARR-segments operated by the residual incumbent still will receive disproportionate shares of available revenue. While this pro-incumbent bias is not as pronounced as it would be under the original ATC methodology,

the Board has articulated a reasonable basis for its finding that a modification was required, and has explained how the original ATC methodology “plainly conflict[s]” with the Board’s purposes. *Decision* at 16

The Board’s basis for modifying the ATC methodology reflects the reasonable conclusion that “[t]raffic must cover its variable cost before it can be expected to make any contribution to joint and common fixed costs ” *Decision* at 16 The modified ATC methodology holds that revenue on any given cross-over traffic movement (even a high-revenue movement) first should be allocated in a manner sufficient to cover each carrier’s variable costs, with any remaining revenue then allocated on the basis of total costs (which themselves are determined by considering relative densities on connecting line segments).⁹ While AEP Texas continues to maintain that the Board’s ATC methodology is fundamentally flawed, there is nothing in the Board’s decision in *Major Issues* that would preclude the Board from revisiting the formula following its first application in an actual case, and determining that it should limit the application of the ATC allocation methodology to contribution levels in order to prevent improper cross-subsidies

⁹ BNSF’s argument that this principle somehow “double counts” variable costs (Petition at 17) is unfounded The focus of ATC in both its original and refined forms is in the relative relationship of on-SARR and off-SARR costs as a guide to revenue allocation Having reasonably concluded that the first allocation step should ensure coverage of each segment’s variable costs, the Board’s reference to relative total costs to allocate available contribution revenues does not double-count anything; the lower density segment still receives a disproportionate share of the contribution revenues, in relation to the presumed differential in total costs per ton.

Finally, BNSF suggests in its Petition that if the Board intends to continue using refined ATC, the Board should do so only for low-rated traffic, and should continue to use the original form of ATC for higher-rated movements. See Petition at 20 (“[E]ven if there were a valid reason to ensure that the SARR receives sufficient revenue to cover the incumbent’s URCS variable costs, which there is not, there is no reason to apply the modified ATC methodology to all cross-over traffic, including high-rated traffic”). This proposal runs counter to the Board’s express findings in the *Decision*, and would unnecessarily complicate the cross-over divisions process even further.

As the Board observed in the *Decision*, it should be presumed that all cross-over traffic must cover its variable cost before it makes any contribution to joint and common fixed costs, as that is a fundamental premise of any rational division methodology. *Decision* at 16. The presumption is equally valid whether the movement is “low-rated” or “high-rated”. This finding mandates a change in the manner of calculation for divisions on all cross-over traffic, not a simplistic, results-based fine-tuning of the divisions methodology in limited circumstances. BNSF’s suggestion would invite the Board to adopt a piecemeal approach to calculating divisions that would modify the formula *ad hoc*, based upon the revenue stream for each movement in the SARR traffic group.

The Board disfavors this type of piecemeal approach, as it explained when it rejected the carriers’ requests in *Major Issues* to preclude some but not all movement-specific adjustments to system-average variable cost determinations. See *Major Issues* at

58 (“[W]e find that such piecemeal adjustments would tend to bias the results in favor of the railroads.”) BNSF’s suggestion would impose this same type of biased piecemeal approach at the SAC level

As noted *supra*, AEP Texas submits that the ATC methodology itself is a flawed and inappropriate means for allocating revenues on cross-over traffic, as it seeks to attribute fixed costs to individual line segments in a manner that ignores the known, obvious disparities in the actual capital investments on the various line segments. This is the same flaw that afflicted various carrier-sponsored formulas that claimed to allocate revenues based on traffic densities, but were rejected by the Board and the Court of Appeals as inconsistent with basic principles underlying the *Coal Rate Guidelines*. See, e.g., *BNSF Railway Company*, 453 F.3d at 484; *PSCO/Xcel* at 17-18. Nevertheless, AEP Texas submits that if the Board is committed to the continuing use of the ATC divisions methodology, the refinement adopted in this case is reasonable, and cannot be faulted as materially erroneous based on the reasons offered by BNSF.

CONCLUSION

For the reasons set forth herein, BNSF's Petition for Reconsideration
should be denied.

Respectfully submitted,

AEP TEXAS NORTH COMPANY
1 Riverside Plaza
Columbus, OH 43215

By David M. Cohen
Senior Counsel
155 West Nationwide Boulevard
Suite 300
Columbus, OH 43215

OF COUNSEL:

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

William L. Slover
Kelvin J. Dowd 
Andrew B. Kolesar III
Slover & Loftus
1224 Seventeenth Street N.W.
Washington, D.C. 20036
(202) 347-7170

Dated November 13, 2007

Attorneys & Practitioners

CERTIFICATE OF SERVICE

I hereby certify that on this 13th day of November 2007, I caused a copy of the foregoing Reply to be served by hand delivery on counsel for BNSF, as follows

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



Kelvin J Dowd