

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

WESTERN FUELS ASSOCIATION, INC.)	
and BASIN ELECTRIC POWER)	
COOPERATIVE, INC.)	STB Docket No. 42088
v.)	
BNSF RAILWAY COMPANY)	

**BNSF RAILWAY COMPANY'S
OPPOSITION TO PETITION FOR RECONSIDERATION**

BNSF Railway Company ("BNSF") hereby responds in opposition to the October 22, 2007 Petition for Reconsideration ("Petition") of the Board's September 10, 2007 Decision in the above-captioned matter ("Decision"), filed by complainants Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. (collectively referred to as "WFA/Basin"). For the reasons set forth below, WFA/Basin's Petition should be denied.

I. There is Nothing Unfair About the Results of the Board's SAC Analysis

Throughout this proceeding, WFA/Basin have sought to influence the Board's assessment of SAC evidence by insisting that the challenged rates are somehow "unfair" because they are higher than the rates WFA/Basin believe they should pay. WFA/Basin take this argument one step further in their petition for reconsideration and claim that because the SAC test showed the supposedly unfair rates to be reasonable, the Board must "reconsider its Decision and redetermine this case in a manner that does produce fair results." Petition at 7. WFA/Basin purport to justify such an arbitrary and result-oriented approach on grounds that "rate reasonableness is a judgment call." Petition at 3. WFA/Basin would apparently have the Board abandon market-based rate reasonableness principles adopted after the Staggers Act and return to

an application of cost and distance based regulation as applied almost one hundred years ago.

Petition at 6 n.16.

The simple response to WFA/Basin's argument is that a subjective belief that a rate is too high, no matter how stridently asserted, does not render a rate unreasonable; nor does it justify a wholesale abandonment of the SAC test. The SAC test was developed as a means of objectively measuring rate reasonableness. SAC procedures, when applied in a manner consistent with Ramsey Pricing principles, result in rates that minimize the economic inefficiency that can result from rate regulation. Rates that pass muster under the SAC test are "fair" because they reflect the shipper's demand for the transportation service while ensuring that the shipper is not being forced to subsidize other shippers or to bear the costs of facilities that it does not use. Such rates maximize public welfare by allowing resources to be allocated in an efficient manner.

The Board properly concluded that the challenged rates are reasonable when measured against the objective standard of the SAC test. The Board also observed that the challenged rates are commercially reasonable even without the objective demonstration provided by the SAC analysis. The Board explained that the rate under the expiring contract had dropped significantly over a twenty year period during which "railroad costs increased approximately 60% and demand for PRB coal production increased by 500%." Decision at 2. The Board also noted:

[T]he rate to the Laramie River plant is one of the lowest transportation rates any utility pays to acquire PRB coal. . . . Even in comparison to other utilities located near (but not quite as close to) the PRB mines, the rate is low on a dollar-per-ton basis. The rate is also low in comparison to other PRB rates that have been challenged before the Board as unreasonable by other captive shippers.

Id.

WFA/Basin are not entitled to the low rates they think would be "fair" simply because of their proximity to the PRB. WFA/Basin complain that the challenged rates have high R/VC

ratios. It is true the R/VC ratios on this short-haul movement are relatively high. But the value of the traffic to BNSF is reflected by the contribution in dollars realized on the traffic rather than the R/VC ratio. Contribution is the revenue available to defray BNSF's unattributable costs and revenue that will be available for reinvestment in PRB capacity. BNSF has limited capacity to originate coal from the PRB and the demand for that capacity is growing. BNSF therefore incurs an opportunity cost when it uses its limited capacity to originate PRB coal on short-haul movements with low contribution. Artificially holding down the revenue generated by a high-volume shipper like WFA/Basin would impose a substantial opportunity cost on BNSF.

II. It Would Be Arbitrary and Unreasonable for the Board to Apply MSP on an Interim Basis

WFA/Basin claim that the Decision "reaches manifestly unreasonable results principally due to the Board's unlawful decision to adopt and retroactively apply the Board's new [ATC] methodology. . . ." Petition at 1. WFA/Basin do not set out the legal grounds for their claim that the application of ATC was impermissibly retroactive. Instead, WFA/Basin are pursuing their retroactivity claim in their appeal of the Board's October 30, 2007 decision in Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases*, where the Board adopted the ATC methodology and notified the parties that it would apply ATC in this proceeding. *See Western Fuels Association v. STB*, Docket No. 06-1399, Petition for Review (D.C. Cir. Filed Dec. 6, 2006). The flaws in WFA/Basin's retroactivity claim will be addressed in that proceeding and there is no need to address those issues again here.

WFA/Basin's Petition complains about retroactivity but challenges a different aspect of the Board's Decision. WFA/Basin argue that, having determined that it was unfair to apply ATC in this case, the Board should have used MSP on an interim basis, subject to a prospective modification of any rate prescription that results from the use of MSP. During the time it would

take BNSF to modify or eliminate the rate prescription on grounds that adoption of ATC constitutes a changed circumstance, WFA/Basin would be the beneficiaries of rate relief grounded on the application of the flawed MSP methodology. WFA/Basin's proposal is unprecedented and makes no sense.

First, WFA/Basin mischaracterize the Board's decision. The Board did not find that application of ATC in this case was unfair to WFA/Basin. The Board concluded that ATC was a more accurate cost-based revenue allocation methodology than MSP, and therefore it was necessary to apply ATC to ensure the reliability of the SAC analysis. The Board clearly did not believe it was unfair to WFA/Basin to assess their rate reasonableness claims under the more accurate ATC methodology. Indeed, the Board explained that "[w]e do not believe it is appropriate to apply flawed or discredited procedures. . . ." Decision at 20. It would have been patently unfair to BNSF to apply the inaccurate MSP methodology in this case since a more accurate methodology had been identified.

The Board did conclude that "fairness dictates that WFA have an opportunity to modify its SAC presentation in light of the new revenue allocation methodology." *Id.* BNSF has explained in its Petition for Reconsideration why it believes the Board was wrong in concluding that WFA/Basin should be given another opportunity to submit SAC evidence. Fairness does not dictate that WFA/Basin be given another chance. WFA/Basin chose to design a SARR that took advantage of MSP's inaccurate allocation of revenue to high-density lines knowing full well that the Board might reject such a methodology. WFA/Basin should be held responsible for the litigation choices they made.

Even if the Board had concluded that the application of ATC was somehow unfair to WFA/Basin, WFA/Basin's proposal to apply MSP on an interim basis would violate the D.C.

Circuit's directive in *BNSF Railway Co. v. Surface Transportation Board*, 453 F.3d 473, 484 (D.C. Cir. 2006), that "were the Board presented with a model that took account both of the economies of density and of the diminishing returns thereto, a decision to adhere to its MSP mode would be on shaky ground indeed." Because ATC satisfies the requirements described by the court, continuing to apply MSP is not an option.

Moreover, WFA/Basin's proposal is clearly inappropriate. WFA/Basin believe that application of the inaccurate MSP methodology would result in a rate prescription. They propose that they be allowed to benefit from such a flawed rate prescription during the time that it would take for BNSF to seek a prospective modification or elimination of the rate prescription based on an argument that adoption of ATC was a changed circumstance. There is no basis for such an opportunistic proposal.

The *San Antonio* cases do not support WFA/Basin's proposal. In those cases, an interim rate was prescribed while the ICC considered alternative rate reasonableness approaches. *San Antonio v. Burlington Northern, Inc.*, 359 I.C.C. 1, 2 (1978). When the preferred methodology was identified, the interim rate prescription was modified. *San Antonio v. Burlington Northern, Inc.*, 361 I.C.C. 482, 491 (1979). The difference between the *San Antonio* cases and this case is that in *San Antonio* the ICC had not yet identified the preferred methodology at the time it established an interim rate prescription. Here, the Board has concluded that ATC is the superior methodology. It would be arbitrary to apply the inaccurate MSP methodology on an interim basis when the superior ATC methodology has already been identified.

III. There Is No Reason for the Board to Update EIA Forecasts

WFA/Basin argue that the Board erred in failing to update the EIA AEO forecast used in its SAC analysis from the 2006 forecast submitted by the parties in their last round of evidence to the 2007 forecast that had become available by the time the Board issued its Decision. But the

Board properly exercised its discretion not to further complicate or delay proceedings in this case by updating the 2006 EIA forecast or by investigating whether other updates were required. As the Board pointed out, “[f]orecasts are continually shifting, and implementing changes to forecasts, particularly volume forecasts, can be burdensome and could necessitate reconfiguration of the network and a new operating model.” Decision at 28.

Moreover, there is no reason to believe that the use of an updated EIA forecast would have changed the Board’s finding that SAC costs exceed SAC revenues. Thus, if the Board accepts BNSF’s position that WFA/Basin should not be given another opportunity to submit SAC evidence, updating the EIA forecast would serve no purpose whatsoever.

IV. The Board Should Not Change its Treatment of Cost of Capital

WFA/Basin raise two issues with respect to the Board’s treatment of cost of capital. First, WFA/Basin ask that the Board specify in its reconsideration decision how the Board will respond to a decision by the D.C. Circuit in the appeal of the Board’s 2005 cost of capital calculation, *Western Coal Traffic League v. STB*, No. 07-1064 (D.C. Cir. filed Mar. 13, 2007). It is not possible for the Board to say how it would respond to a decision by the reviewing court until it sees the decision and it is inappropriate to ask the Board to speculate about its response.

Second, WFA/Basin argue that the Board’s initiation of a proceeding in *Methodology to Be Employed in Determining the Railroad Industry’s Cost of Capital*, STB Ex Parte No. 664 (“EP 664”), should be considered a changed circumstance that justifies recalculation of the cost of capital for “all periods covered by the DCF model.” Petition at 14. As a preliminary matter, the Board’s initiation of a rulemaking proceeding to investigate changes to an established methodology cannot reasonably be considered a changed circumstance for purposes of 49 C.F.R. § 1115.3. The Notice initiating the rulemaking merely indicated that the Board was

contemplating modifying its procedures; the Notice did not and could not predetermine what change, if any, would be made at the conclusion of the process.

More important, even if the Board were to change the methodology used to calculate the railroad industry cost of capital, that would not be a changed circumstance that affects the Board's decision in this case. If a change is made to the cost of capital methodology, that change will only affect the cost of capital calculations for future years. The change would have no impact at all on the historical cost of capital calculations used in this case. As the Board noted in the September 10, 2007 decision in *AEP Texas North Company v. BNSF Railway Company*, STB Docket No. 41191 (Sub-No.1)(“*AEP Texas Decision*”), slip op. at 108, “whatever change we may adopt [in EP 664] would not be applied retroactively.”

WFA/Basin assert that “fairness dictates that if the Board adopts CAPM, the Board should [] apply properly calculated CAPM-based cost of capital calculations to all periods covered by the DCF model.” Petition at 14. WFA/Basin ignore the long established practice in SAC cases regarding the cost of capital assumptions used in the DCF analysis. SAC cost of capital calculations are a routine application of the separate cost of capital determinations made annually in Ex Parte No. 558. The parties do not submit evidence in SAC cases relating to alternative annual cost of capital figures. The validity of the cost of capital inputs calculated in separate proceedings is not an issue in SAC cases. SAC cases are already burdensome and complicated, and litigation burdens would be needlessly expanded if decisions relating to the industry cost of capital reached in separate proceedings could be relitigated in a SAC case.

V. The Board Properly Accepted BNSF's Fuel Price Evidence that Eliminated the Effect of Hedging

WFA/Basin ask the Board to reconsider its decision to accept BNSF's location-specific fuel price evidence. WFA/Basin argue that location-specific fuel prices were inaccurate because

they do not include the effect of BNSF's fuel price hedging. WFA/Basin contend that they are entitled to use a base year fuel cost that includes a substantial, one-year hedging benefit. The Board correctly decided that the effects of fuel price hedging have no place in a SAC analysis.

WFA/Basin make the disingenuous argument that by incorporating the hedge effect in the base year price they are simply establishing "accurate base period fuel prices." Petition at 15. As WFA/Basin are well aware, using their hedged fuel price for the base year would have built into the DCF analysis a 24% discount of the cost of fuel which would have been perpetuated throughout the DCF period by the "forecast methodology" that WFA/Basin proposed to use. *See* Final Brief of BNSF Railway Company, at 17-18 (filed Dec. 6, 2005).

The Board correctly recognized that allowing WFA/Basin to use a substantially discounted fuel price in the base year would be inappropriate since it is unreasonable to expect that WFA/Basin would be able to achieve the same level of discount each year through hedging. Indeed, the hedging benefits that might be achieved in one year could easily be neutralized by hedging losses in subsequent years. As the Board explained:

Fuel cost hedging would not result in a uniform reduction of costs. Rather, hedging results in a rise and fall of costs based on the market's fluctuations and the skill of the hedgers. Thus, to use a single year's hedging results for long-term forecasting of fuel costs is unrealistic.

Decision at 38. The Board's decision to exclude the effect of hedging from the SAC analysis was correct.

VI. The Board Properly Declined to Consider Debt Amortization Evidence that WFA/Basin Held Back Until Rebuttal

WFA/Basin also request that the Board reconsider its decision to reject WFA/Basin's evidence on debt amortization. WFA/Basin sought to have the Board depart from longstanding precedent in the treatment of the SARR's debt based on evidence and arguments submitted for

the first time on rebuttal. The Board correctly declined to address WFA/Basin's late-filed evidence.

As the Board is aware, WFA/Basin buried their assumption concerning debt amortization in a workpaper on opening. Even though WFA/Basin's 50-year amortization assumption departed from precedent, WFA/Basin made no effort at that time to justify or even identify this departure from precedent. But a complainant is required to set out its assumptions *and the evidence in support* on opening in order to permit the defendant railroad a meaningful reply. As happened in this case, if a complainant fails to present evidence supporting its assumptions on opening, the railroad can only point out the error without any ability to respond to the complainant's unknown reasoning or evidence. Due process in adjudicated cases requires that a party have the opportunity to contest the evidence offered by its opponent. WFA/Basin advocate a rule that would instead permit complainants to submit their cases essentially unchallenged. The Board properly declined to accept such an approach: "a departure from agency precedent must be identified and justified on opening, so that the defendant has an opportunity to respond." Decision at 136.

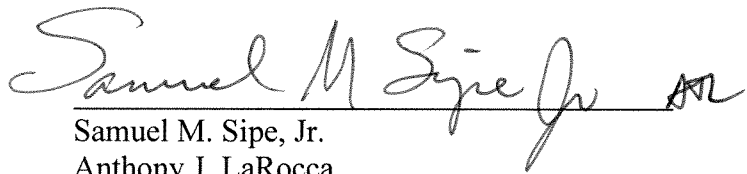
While the Board did not address the merits of WFA/Basin's evidence on this issue, the Board did address the issue of debt amortization in the *AEP Texas Decision*. In their Petition, WFA/Basin assert that the Board was wrong in that case in rejecting on the merits AEP Texas' similar attempt to make use of exceptionally long debt amortization periods. Although the Board's *AEP Texas Decision* is not properly at issue in this proceeding, WFA/Basin's challenge to the Board's conclusions in that case is clearly unfounded. WFA/Basin characterize the issue as the "feasibility" of amortizing all SARR debt over extraordinarily long periods. Feasibility is precisely what AEP Texas failed to show. At most, AEP Texas demonstrated that on some

occasions, under some circumstances, and at some unspecified costs, railroads are able to incur debt for periods longer than 20 years. The fact that railroads *may* obtain debt financing over long periods under some circumstances does not mean that AEP Texas would be able to obtain *all* of its financing under different circumstances and conditions without any increase in cost. As the Board concluded, long-term amortization is the exception rather than the rule: “although some debt may be issued for longer than 20 years, most debt is amortized over considerably less than 20 years. Therefore, we follow the long-standing precedent for amortizing the SARR debt over a 20-year period.” *AEP Texas Decision*, slip op. at 107.

VII. Conclusion

For all the foregoing reasons, WFA/Basin’s Petition for Reconsideration should be denied.

Respectfully submitted,

A handwritten signature in cursive script, reading "Samuel M. Sipe, Jr.", followed by a small monogram "AS".

Samuel M. Sipe, Jr.
Anthony J. LaRocca
Linda S. Stein
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, DC 20036
(202) 429-3000

Richard E. Weicher
Jill K. Mulligan
BNSF Railway Company
2500 Lou Menk Drive
Fort Worth, TX 76131
(817) 352-2353

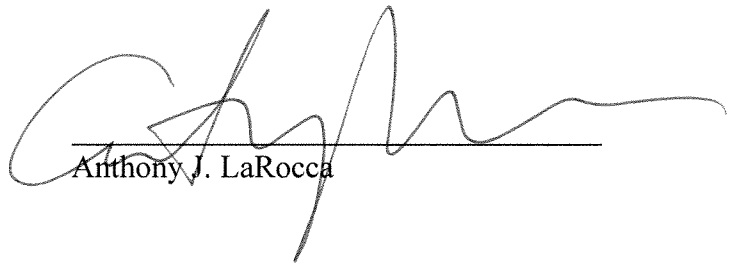
Attorneys for BNSF Railway Company

November 13, 2007

CERTIFICATE OF SERVICE

I hereby certify that this 13th day of November, 2007, I served a copy of BNSF's
Opposition to Petition For Reconsideration on the following by hand delivery:

John H. LeSeur
Christopher A. Mills
Peter H. Pfohl
Daniel M. Jaffe
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, DC 20036



Anthony J. LaRocca