

Second, the Board will need to determine whether the variable costs for the Southwestern Railroad (“SWRR”) should be recalculated using a restated Western Region URCS. BNSF believes that the only adjustments that should be made to variable costs in 2010-2012 are to BNSF’s costs. However, if the Western Region URCS are recalculated and used to restate the jurisdictional threshold, then the Board will also need to recalculate the jurisdictional threshold for 2011 using UP’s 2011 URCS.

Third, the Board will need to decide whether BNSF’s rates for 2013-2016 will include an increasing percentage of the asset markup associated with the Berkshire Hathaway acquisition of BNSF, as provided in the Board’s July 25, 2013 decision in Docket No. FD 35506. AEPCO claims, contrary to the Board’s decision in Docket No. FD 35506, that BNSF is not entitled to reflect any portion of the asset markup in the prescribed rates until 2015.

I. Background

On November 22, 2011, the Board served a decision in this proceeding finding that the rates charged by BNSF and UP for unit coal train transportation to AEPCO’s Apache Generating Station were unreasonably high.¹ The Board ordered the railroads to pay reparations and “to establish and maintain rates for movements of the issue traffic that do not exceed the maximum reasonable revenue-to-variable cost levels prescribed in this decision.” Nov. 22, 2011 Decision at 39. The Board prescribed rates at the jurisdictional threshold, directing that the prescribed rates should “not exceed 180% of the variable costs of providing the service.” *Id.* Variable costs were to be calculated “pursuant to unadjusted URCS, with indexing as appropriate.” *Id.*

After the Board issued its decision, the parties conferred and agreed on the amount of reparations due to AEPCO for the period 2009-2011. On April 27, 2012, the Board granted

¹ *Arizona Electric Power Cooperative, Inc. v. BNSF Railway Co.*, STB Docket No. 42113, slip op. (served Nov. 22, 2011) (“Nov. 22, 2011 Decision”).

AEPCO's unopposed petition for an order directing the railroads to pay AEPCO approximately \$9,244,144 in reparations and interest for freight shipments tendered between January 2, 2009 and December 30, 2011. In addition, for movements beginning on January 1, 2012, BNSF and UP established proportional rates for their respective portions of the through movement set at the jurisdictional threshold of 180% of each carrier's variable costs.²

Meanwhile, on January 20, 2012, the Board granted AEPCO's petition to reopen this proceeding and lift the prescriptive effect of the rate prescription pending resolution of the proceeding in *Western Coal Traffic League—Petition for Declaratory Order*, FD 35506 (“*Western Coal*”). In *Western Coal*, the Western Coal Traffic League asked the Board to adjust BNSF's URCS data for 2010 and subsequent years to exclude the markup of BNSF's railroad assets that was attributable to Berkshire Hathaway's 2010 purchase of BNSF. The parties in this proceeding agreed that, pending the outcome of *Western Coal*, the railroads “w[ould] not charge more than the jurisdictional threshold calculated based on inclusion of the acquisition premium” and that AEPCO would be entitled to lower rates, in the form of a refund, if the Board determined in *Western Coal* that BNSF's URCS costs should not reflect some or all of the markup. *Arizona Electric Power Cooperative, Inc. v. BNSF Railway Co.*, STB Docket No. 42113, AEPCO's Petition Responding to the December 9, 2011 Order Served By the Board in Finance Docket No. 35506, at 3 (filed Dec. 20, 2011).

On July 25, 2013, the Board issued its decision in *Western Coal*. Although the Board “decided not to alter its accounting rules for acquisitions,” it took two actions to address the “unique circumstances” surrounding Berkshire's acquisition of BNSF. *Western Coal*, slip op. at

² BNSF's proportional rate is determined by adding 180% of BNSF's variable costs and 180% of SWRR's variable costs. On May 22, 2012, the Board denied AEPCO's petition requesting that the Board order BNSF and UP to publish joint rates. AEPCO has appealed this issue to the D.C. Circuit. *See Ariz. Elec. Power Coop., Inc. v. STB*, No. 12-1246 (D.C. Cir.).

2 (served July 25, 2013). First, because Berkshire had inadvertently failed to seek and obtain required Board approval for its acquisition of BNSF, the Board “direct[ed] BNSF to resubmit its STB Form R-1 submissions for 2010, 2011, and 2012 without the markup.” *Id.* Second, because of its “concern[] about the near-term impacts resulting from the full markup of rail assets in one year under the unique circumstances” of Berkshire’s acquisition of BNSF, the Board adopted a four-year transitional period during which BNSF would be entitled to reflect an increasing percentage of the asset markup in its costs. *Id.* at 29-30. The Board explained that it “chose[] to mitigate the impact of BNSF’s asset write-ups over a seven-year period (combining the three-year delay and four-year transition period) so as to capture a full business cycle.” *Id.* at 30.

Concurrent with the decision in *Western Coal*, the Board instructed the parties in this proceeding to “advise the Board on approaches to reinstating the rate prescription in this proceeding by September 23, 2013.” *Arizona Electric Power Cooperative, Inc. v. BNSF Railway Co.*, STB Docket No. 42113, slip op. at 3 (served July 25, 2013). AEPCO and the railroads have conferred but, as explained below, were unable to reach agreement on the proper implementation of the Board’s decision in *Western Coal* to reinstate the rate prescription in this proceeding.³

II. Argument

The Board will need to resolve three issues to reinstitute the rate prescription in this proceeding. The three issues are discussed below.

A. The Most Recent URCS Data Currently Available For A Given Year Should Be Used To Recalculate The Jurisdictional Threshold For Historical Periods.

BNSF and AEPCO disagree as to which URCS should be used for historical periods to recalculate the jurisdictional threshold. For 2010, the parties agree that the restated BNSF 2010 URCS (based on a revised R-1 that excludes the asset markup) should be used to recalculate

³ The e-mail correspondence among the parties is attached at Exhibit 1.

BNSF's 2010 variable costs. AEPCO contends that the restated BNSF 2010 URCS should also be used with various indices to recalculate BNSF's variable costs for 2011 and 2012. For 2013, AEPCO claims that BNSF's restated 2011 URCS with indices should be used to recalculate BNSF's variable costs. BNSF disagrees.

There is no reason to rely on indexed versions of outdated URCS to recalculate the jurisdictional threshold for historical periods as AEPCO proposes. The Board instructed BNSF to restate its R-1 reports for 2010, 2011 and 2012. The Board will issue restated BNSF URCS for each of these years. The URCS corresponding to the year in which a movement occurred will be available for the years 2010-2012 and should be used to determine BNSF's variable costs for that year. BNSF's restated 2011 URCS should be used to calculate BNSF's variable costs for 2011, and BNSF's 2012 URCS should be used to calculate BNSF's variable costs for 2012. While a 2013 BNSF URCS will not be available until late 2014, BNSF's 2012 URCS, which will be available by the end of 2013, should be used to calculate BNSF's variable costs for 2013 rather than relying on an older 2011 URCS.

AEPCO's position that an outdated URCS should be used to calculate BNSF's variable costs for historical periods is an obvious attempt to take advantage of the understatement of fuel costs that results from the use of an index to update 2010 URCS costs to 2011 and 2012 as opposed to recalculating variable costs using the actual 2011 and 2012 URCS.⁴ There was a dramatic increase in fuel costs between 2010 and 2011/2012. BNSF's fuel costs per gallon increased by 37% from 2010 to 2011. For the period 2010-2012, fuel cost per gallon increased

⁴ The discussion on pages 5-6 regarding BNSF's fuel costs and the corresponding Exhibit 2 are verified by FTI's Benton V. Fisher.

44%.⁵ The indices that would be applied to update BNSF's 2010 URCS variable costs to 2011 and 2012 to account for this fuel price increase assume that fuel costs are 16% of the total cost of the movement.⁶ This weighting of fuel cost is based on the relative mix of BNSF's total costs system-wide. However, fuel costs represent a much higher percentage of the variable costs that URCS assigns to the AEPCO movement. Exhibit 2 shows that URCS estimates that fuel accounts for 24% of BNSF's total variable costs for the AEPCO shipments.

When fuel costs are assumed to be 16% of total variable cost – the assumption used in the 2010 index – a 37% increase in fuel costs will produce a 6% increase in total cost (37% times 16%). When fuel costs are assumed to be 24% of total variable cost – the 2010 URCS-based weighting of fuel for the AEPCO movement – a 37% increase in fuel costs will produce a 9% increase in total cost (37% times 24%). The use of an index applied to 2010 URCS costs to estimate 2011 and 2012 costs therefore understates the impact of the fuel price increases on the URCS variable costs of the AEPCO movement from 2010 to 2011/2012. The use of an index is necessary to approximate later period costs when those later period costs are not available. But when the actual costs are available for the later time periods, it makes no sense to continue relying on an index.

BNSF's 2011 and 2012 URCS accurately reflect the impact of those fuel price increases and there is no reason to ignore the actual 2011 and 2012 URCS costs in favor of indexed costs. The fact that an outdated URCS was used previously to determine the rates for 2010-2012 is

⁵ Schedule 750 to BNSF's annual R-1 reports identify fuel costs per gallon of \$2.23 in 2010, \$3.05 in 2011, and \$3.20 in 2012.

⁶ Schedule 410 to BNSF's 2010 R-1 identifies fuel costs of \$2.9 billion and total operating expenses of \$12.6 billion. Worktable D8 Line 135 from the Board's 2010 URCS Phase II cost file identifies total ROI costs for BNSF of \$5.3 billion. \$2.9 billion divided by \$17.9 billion equals 16%.

irrelevant. The outdated URCS were the most recent available URCS to use at the time the jurisdictional threshold calculations were previously made. But those calculations must now be modified, under the unique circumstances of this case, and a current URCS will be available to make the necessary calculations.

In the parties' discussions, AEPCO indicated that it believes the Board's decision in *Oklahoma Gas & Electric Company v. Union Pacific Railroad Company*, No. 42111, slip op. at 9 (served July 24, 2009) ("*OG&E*"), supports AEPCO's proposed use of an outdated URCS. AEPCO misreads the *OG&E* decision. The basic principle underlying the procedures announced by the Board in *OG&E* to determine the level of a prescribed rate is that indices should be relied on to update an older URCS to the minimum extent possible.⁷ Here, the use of indices can be avoided altogether for the years 2011 and 2012, because 2011 and 2012 URCS will be available to establish the jurisdictional threshold for each year. BNSF's proposed approach to retroactively adjusting historical year calculations to establish the jurisdictional threshold for those prior years is fully consistent with *OG&E*.

For these reasons, the Board should order the parties to use BNSF's revised 2011 URCS data to modify reparations that have already been paid for 2011 and to use BNSF's revised 2012

⁷ This principle is consistent with long-standing case law that favors use of the most current URCS wherever possible. *See W. Fuels Ass'n, Inc. v. BNSF Ry. Co.*, No. 42088, slip op. at 6-9 (served July 27, 2009) (holding that calculation of actual maximum lawful rates should be based on most recent URCS data available rather than older URCS data that had been used to calculate maximum markup R/VC levels); *Cost Recovery Percentage*, ICC Ex Parte No. 399, slip op. at 3-4 (ICC served Dec. 23, 1983) (concluding that for computing Cost Recovery Percentage, "it is preferable to use actual costs developed for the subject year rather than costs developed for a prior year updated to a subsequent year" and stating that "when actual costs for the waybill year are not available we will use unit costs for the latest year available, appropriately updated"). The Board has used the most current URCS available at the time of its decision to calculate variable costs even though that vintage URCS was not available when the parties submitted their evidence. *See FMC Wyo. Corp. v. Union Pac. R.R. Co.*, No. 42022, slip op. at 49 (served May 12, 2000).

URCS data to determine the jurisdictional threshold rates for 2012 and 2013 and the refunds that will be due to AEPCO on movements that occurred during those two years.

B. There Is No Reason To Make Any Changes To The Western Region URCS For Historical Periods.

In the parties' discussions following the Board's July 25, 2013 decision in this proceeding, AEPCO indicated that it expects the Board to issue a revised Western Region URCS for the years 2010-2011 to be used to recalculate the variable costs for the SWRR in establishing the jurisdictional threshold for historical years. There is no indication in the Board's decision in this proceeding or in the *Western Coal* decision that the Board intends to reissue the Western Region URCS for 2010-2011, nor is there any reason for the Board to do so.

The Board's July 25, 2013 decisions in this proceeding and in *Western Coal* focus only on BNSF. The Board's decision to disallow the asset markup for 2010-2012 was a response to Berkshire's inadvertent non-compliance with the rules applicable to the acquisition of BNSF. The remedy imposed by the Board – temporary disallowance of the asset markup – was directed solely to BNSF. SWRR is a separate railroad from BNSF for purposes of establishing the variable costs of the AEPCO movement. SWRR had nothing to do with the circumstances giving rise to the Board's adoption of the non-compliance remedy, and its assumed costs should not be affected by implementation of the remedy that is directed to BNSF.

Moreover, the restatement of BNSF's URCS costs for 2010 and 2011 is not intended to correct an inaccuracy in BNSF's costs. Indeed, the Board repeatedly acknowledged in the *Western Coal* decision that “[p]urchase accounting is required by GAAP.” *Western Coal*, slip op. at 21 (served July 25, 2013). Since the remedy imposed by the Board on BNSF is not intended to correct an inaccuracy in BNSF's R-1 but rather is “designed to encourage full compliance with the requirements of the Interstate Commerce Act and to deter similar non-

compliance in the future,” *id.* at 28, there is no reason to extend the restatement of historical year variable costs to railroads other than BNSF.

Logic dictates that the Board should limit the recalculation of variable costs in response to the *Western Coal* decision to the costs of BNSF. But if the Board were to require a more extensive revision of the variable cost calculations, then the Board should revise the 2011 jurisdictional threshold calculations using updated URCS for all three carriers that participate in the AEPCO movement, BNSF, SWRR and UP. It would not be appropriate to recalculate the 2011 variable costs for BNSF, using BNSF’s 2011 URCS costs, and for the SWRR, using a restated 2011 Western Region URCS that is based in part on BNSF’s and UP’s 2011 URCS costs, but to leave the variable cost calculation for UP’s portion of the movement based on an outdated 2010 UP URCS. Consistency would require a recalculation of UP’s 2011 variable costs for the UP portion of the movement using the 2011 UP URCS.

C. The Board Should Allow BNSF To Begin Reflecting The Asset Markup In Its 2013 Rates.

In *Western Coal*, the Board decided to “delay[] the \$8.1 [b]illion markup of the rail assets until 2013 due to Berkshire’s noncompliance with §11323.” *Western Coal*, slip op. at 29 (served July 25, 2013). AEPCO, however, proposes that BNSF be prevented from realizing any effect of the asset markup until 2015, two years beyond the year that the Board ruled that BNSF could begin reflecting a portion of the asset markup in its costs. AEPCO’s position is not consistent with the Board’s decision “to mitigate the impact of BNSF’s asset write-ups over a seven-year period (combining the three-year delay and four-year transition period).” *Id.* Under AEPCO’s proposed approach, the impact of BNSF’s asset write-up would be extended over a nine-year period – from 2010-2018. The delay in recognizing any portion of the asset markup would not be three years as the Board indicated (2010-2012), but rather would be five years (2010-2014).

Indeed, under AEPCO's proposed approach, BNSF would not be entitled to a full recognition of the asset markup until the last year of the rate prescription.

AEPCO seeks to extend the period of the non-compliance remedy to five years by taking advantage of the regulatory delay between the preparation of an R-1 and the issuance of an URCS. BNSF's 2013 URCS will include 25% of the asset markup as part of the transition to full recognition of the asset markup, but BNSF's 2013 URCS will not be available until 2015. It is nevertheless possible to refine the rate calculations based on the 2012 URCS, which will not include any portion of the asset markup, to allow the transitional inclusion of the asset markup beginning in 2013, as the Board provided. BNSF proposes the following approach:

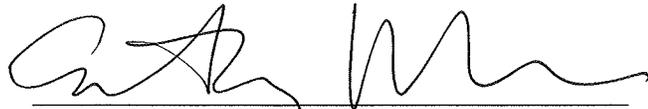
First, BNSF's 2013 variable costs for the AEPCO movement would be calculated using BNSF's 2012 URCS with the standard indices to bring 2012 costs to 2013 levels. These costs will not include any portion of the asset markup. Second, the variable costs of the AEPCO movement associated with the asset markup would be calculated by determining the difference in variable costs between the URCS variable costs with the asset markup and the URCS variable costs without the asset markup for the AEPCO movement for the years 2010 and 2011. Third, one quarter of the markup-related variable costs determined in Step 2 above would be added to the variable costs calculated in Step 1 above to determine the jurisdictional threshold rate. For future years, this methodology could be used to ensure that an increasing amount of the asset markup is reflected in BNSF's variable costs over the transition period, as required by the Board in *Western Coal*.⁸

⁸ The specific application of this methodology to future years is set out in the September 18, 2013 e-mail from Anthony LaRocca to Robert Rosenberg, contained in Exhibit 1.

III. Conclusion

The Board should adopt the approach described above for reinstating the rate prescription in this proceeding.

Respectfully submitted,



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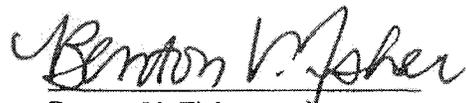
Attorneys for BNSF Railway Company

September 23, 2013

VERIFICATION

I, Benton V. Fisher, Senior Managing Director of FTI Consulting, declare under penalty of perjury that I have read the foregoing BNSF's Position on Disputed Issues Relating to Reinstating the Rate Prescription and that the discussion therein regarding BNSF's fuel costs and the corresponding Exhibit 2 are true and correct. Further, I certify that I am qualified and authorized to file this verification.

Executed on September 23, 2013.


Benton V. Fisher

CERTIFICATE OF SERVICE

I hereby certify that this 23rd day of September 2013, a copy of BNSF's Position on Disputed Issues Relating to Reinstating the Rate Prescription was served on the following by hand delivery:

William L. Slover
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, DC 20036

Michael L. Rosenthal
Covington & Burling LLP
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004



Roy E. Litland

LaRocca, Anthony

From: Robert Rosenberg <rdr@sloverandloftus.com>
Sent: Wednesday, September 11, 2013 1:14 PM
To: LaRocca, Anthony; Mike Rosenthal (mrosenthal@cov.com); Louise A. Rinn [LARINN@up.com] (LARINN@up.com)
Subject: AEPCO prescription/rates and BNSF acquisition markup

Tony, Mike, and Lou Anne:

The STB's July 24, 2013 decision directs AEPCO and Defendants BNSF and UP to confer on approaches to reinstating the rate prescription and to advise the STB by September 23, 2013. Please consider this note as initiating the discussion. We would be pleased to confer by telephone, but this matter has enough parts that we thought an email would be the better way to tee things up.

The STB has directed BNSF to file corrected R-1 reports for 2010-2012 by September 23, 2013. We expect that the STB will then prepare the corrected URCS formulas for both BNSF and the Western Region (SWRR) for 2010-2011 and the URCS formulas for 2012. Since the 2010 URCS formulas were used to calculate AEPCO's reparations for 2010-2011, we expect that the corrected 2010 URCS formulas will be used to calculate additional reparations due AEPCO for 2010 and 2011. Since the 2010 URCS formulas were also used to calculate AEPCO's rates for 2012 and the first weeks of 2013, the corrected 2010 URCS formulas will also be used to calculate additional reparations due AEPCO for 2012 and the first weeks of 2013. Since the 2011 URCS formulas were used to calculate AEPCO's rates for the remainder of 2013, the corrected 2011 URCS formulas will be used to calculate additional reparations due AEPCO for the remainder of 2013 and the first weeks of 2014. The reparations for 2011-2014 will include interest. Assuming the 2012 URCS formulas are available on a timely basis, they will be used to calculate AEPCO's rates for the remainder of 2014 and the first weeks of 2015. If they are not available on a timely basis, it may be necessary to continue to utilize the 2011 URCS formulas, subject to additional reparations when the correct URCS formulas become available.

We understand that BNSF will begin phasing-in the acquisition write-up with the 2013 R-1. If so, we would expect one-quarter of the write-up to be reflected in the 2013 URCS formulas, which would be expected to be reflected in AEPCO's rates after the first few weeks of 2015. The 2014-2016 URCS formulas will follow in turn for use during 2016-2018.

We do not view any of the above as altering the prescription, which is, and remains, at the jurisdictional threshold of 180% of variable costs. Instead, we view the corrected R-1 reports as resulting in corrected variable costs. Also, we recognize that BNSF and UP implemented proportional rates starting January 1, 2012. Accordingly, the corrected URCS formulas will apply only to the BNSF rates starting that date, contingent upon the outcome of AEPCO's appeal. (We note that AEPCO's appeal could also result in the non-use of the Western Region URCS formula for the SWRR segment.) We believe the report to be filed with the STB should be from AEPCO and both defendants.

If the carriers believe that "refunds" is a more appropriate term than "reparations," please let us know. In addition, please let us know if the carriers believe it necessary to obtain a formal STB order directing the payment of the additional reparations/refunds. Regardless, an order reinstating the

prescription that was temporarily lifted by the January 20, 2012 decision also appears to be necessary.

We look forward to hearing from you.

Robert

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LaRocca, Anthony

From: LaRocca, Anthony
Sent: Friday, September 13, 2013 3:27 PM
To: 'Robert Rosenberg'; Mike Rosenthal (mrosenthal@cov.com); Louise A. Rinn [LARINN@up.com] (LARINN@up.com)
Cc: Sipe, Samuel
Subject: RE: AEPCO prescription/rates and BNSF acquisition markup

Robert: I am responding to your September 11, 2013 e-mail initiating discussions on approaches for reinstating the rate prescription in Docket No. NOR 42113 pursuant to the Board's July 25, 2013 decisions in Docket No. NOR 42113. We have several concerns with your proposed approach.

First, to determine the appropriate amount of reparations due to AEPCO for the period 2010/2011, the jurisdictional threshold for those two years needs to be recalculated. As you note in your e-mail, the Board will be issuing revised 2010 and 2011 BNSF URCS after receiving revised R-1 reports from BNSF that exclude the asset markup resulting from the Berkshire Hathaway acquisition of BNSF. Thus, the 2010 URCS will be available to recalculate the jurisdictional threshold for 2010 and the 2011 URCS will be available to recalculate the jurisdictional threshold for 2011. There is no reason to continue using an outdated 2010 URCS to recalculate the jurisdictional threshold for 2011, as you propose, when a 2011 URCS will be available.

Second, you propose to continue using an outdated 2010 URCS indexed to 2012 to recalculate the jurisdictional threshold for 2012. However, as you acknowledge in your e-mail, the Board has instructed BNSF to submit a new R-1 report for 2012 that excludes the asset markup resulting from the Berkshire Hathaway acquisition of BNSF. The Board will issue a new 2012 BNSF URCS that excludes the markup, probably around the same time that it will issue revised 2010 and 2011 BNSF URCS. Since a valid 2012 URCS will be available to determine the jurisdictional threshold, there is no reason to continue using the 2010 URCS.

Third, you suggest that the Board intends to reissue the Western Region URCS along with revised BNSF URCS for 2010 and 2011. The Western Region URCS is used to determine the Southwest Railroad (SWRR) variable costs. We have no reason to believe that the Board intends to issue a revised Western Region URCS for 2010 and 2011, nor do we read the Board's July 25, 2013 decision in FD 35506 or in NOR 42113 as requiring any adjustment to the Western Region URCS for the historical time period. We believe the recalculation of variable costs should be limited to BNSF's portion of the movement. Indeed, if we were to modify the costs calculated for the SWRR, it would also be necessary to modify the 2011 costs for the UP since we now have a 2011 UP URCS.

Fourth, the Board has allowed BNSF to capture 25% of the asset markup resulting from Berkshire Hathaway's acquisition in BNSF's variable costs starting in 2013 as part of a four-year transition to full recognition of the markup. In contrast, you propose that no portion of the asset markup will be reflected in BNSF's rates until 2015. To reflect 25% of the asset markup in the rates for 2013, we propose the following approach: (1) BNSF's variable costs for the AEPCO movement would first be calculated using BNSF's 2012 URCS which excludes the effect of the asset markup; (2) the incremental variable costs of the AEPCO movement associated with the asset markup would be calculated by comparing the variable costs for the AEPCO movement in 2010 and 2011 using the 2010 and 2011 URCS that include the asset markup and the revised 2010 and 2011 URCS that exclude the asset markup; (3) one quarter of the incremental cost determined in Step 2 above would be added to the variable costs calculated in Step 1 above to determine the jurisdictional threshold rate. For future years, this methodology could be used to ensure that an increasing amount of the asset markup is reflected in BNSF's variable costs over the transition period.

We expect that it will be necessary to discuss these issues in person. Please advise when you are available to discuss. Tony

From: Robert Rosenberg [mailto:rdr@sloverandloftus.com]

Sent: Wednesday, September 11, 2013 1:14 PM

To: LaRocca, Anthony; Mike Rosenthal (mrosenthal@cov.com); Louise A. Rinn [LARINN@up.com] (LARINN@up.com)

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We understand that BNSF will begin phasing-in the acquisition write-up with the 2013 R-1. If so, we would expect one-quarter of the write-up to be reflected in the 2013 URCS formulas, which would be expected to be reflected in AEPCO's rates after the first few weeks of 2015. The 2014-2016 URCS formulas will follow in turn for use during 2016-2018.

We do not view any of the above as altering the prescription, which is, and remains, at the jurisdictional threshold of 180% of variable costs. Instead, we view the corrected R-1 reports as resulting in corrected variable costs. Also, we recognize that BNSF and UP implemented proportional rates starting January 1, 2012. Accordingly, the corrected URCS formulas will apply only to the BNSF rates starting that date, contingent upon the outcome of AEPCO's appeal. (We note that AEPCO's appeal could also result in the non-use of the Western Region URCS formula for the SWRR segment.) We believe the report to be filed with the STB should be from AEPCO and both defendants.

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prescription that was temporarily lifted by the January 20, 2012 decision also appears to be necessary.

We look forward to hearing from you.

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LaRocca, Anthony

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Sent: Monday, September 16, 2013 10:33 AM
To: LaRocca, Anthony; Robert Rosenberg; Louise A. Rinn [LARINN@up.com] (LARINN@up.com)
Cc: Sipe, Samuel; Rosenthal, Michael
Subject: RE: AEPCO prescription/rates and BNSF acquisition markup

Robert and Tony:

UP's view is that, if the Board is going to revisit the reparations due to AEPCO for the period in which there was a joint rate, it should not only use the revised 2010 and 2011 BNSF URCS, but it should also use the most accurate cost information available for UP and SWRR. This means: (1) for 2010, revised 2010 BNSF URCS and existing 2010 UP and Western Region URCS; (2) for 2011, revised 2011 BNSF URCS and existing 2011 UP and Western Region URCS. Unless the DC Circuit reverses the Board's decision allowing UP to establish proportional rates in 2012 and beyond, the years after 2011 are not of concern to UP. (And, even if the DC Circuit were to reverse the decision, UP still might not have any concern, depending on what the court says and what the Board does.)

Regards,

Mike

From: LaRocca, Anthony [mailto:ALaRocca@steptoe.com]
Sent: Friday, September 13, 2013 3:27 PM
To: Robert Rosenberg; Rosenthal, Michael; Louise A. Rinn [LARINN@up.com] (LARINN@up.com)
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Subject: RE: AEPCO prescription/rates and BNSF acquisition markup

Robert: I am responding to your September 11, 2013 e-mail initiating discussions on approaches for reinstating the rate prescription in Docket No. NOR 42113 pursuant to the Board's July 25, 2013 decisions in Docket No. NOR 42113. We have several concerns with your proposed approach.

First, to determine the appropriate amount of reparations due to AEPCO for the period 2010/2011, the jurisdictional threshold for those two years needs to be recalculated. As you note in your e-mail, the Board will be issuing revised 2010 and 2011 BNSF URCS after receiving revised R-1 reports from BNSF that exclude the asset markup resulting from the Berkshire Hathaway acquisition of BNSF. Thus, the 2010 URCS will be available to recalculate the jurisdictional threshold for 2010 and the 2011 URCS will be available to recalculate the jurisdictional threshold for 2011. There is no reason to continue using an outdated 2010 URCS to recalculate the jurisdictional threshold for 2011, as you propose, when a 2011 URCS will be available.

Second, you propose to continue using an outdated 2010 URCS indexed to 2012 to recalculate the jurisdictional threshold for 2012. However, as you acknowledge in your e-mail, the Board has instructed BNSF to submit a new R-1 report for 2012 that excludes the asset markup resulting from the Berkshire Hathaway acquisition of BNSF. The Board will issue a new 2012 BNSF URCS that excludes

the markup, probably around the same time that it will issue revised 2010 and 2011 BNSF URCS. Since a valid 2012 URCS will be available to determine the jurisdictional threshold, there is no reason to continue using the 2010 URCS.

Third, you suggest that the Board intends to reissue the Western Region URCS along with revised BNSF URCS for 2010 and 2011. The Western Region URCS is used to determine the Southwest Railroad (SWRR) variable costs. We have no reason to believe that the Board intends to issue a revised Western Region URCS for 2010 and 2011, nor do we read the Board's July 25, 2013 decision in FD 35506 or in NOR 42113 as requiring any adjustment to the Western Region URCS for the historical time period. We believe the recalculation of variable costs should be limited to BNSF's portion of the movement. Indeed, if we were to modify the costs calculated for the SWRR, it would also be necessary to modify the 2011 costs for the UP since we now have a 2011 UP URCS.

Fourth, the Board has allowed BNSF to capture 25% of the asset markup resulting from Berkshire Hathaway's acquisition in BNSF's variable costs starting in 2013 as part of a four-year transition to full recognition of the markup. In contrast, you propose that no portion of the asset markup will be reflected in BNSF's rates until 2015. To reflect 25% of the asset markup in the rates for 2013, we propose the following approach: (1) BNSF's variable costs for the AEPCO movement would first be calculated using BNSF's 2012 URCS which excludes the effect of the asset markup; (2) the incremental variable costs of the AEPCO movement associated with the asset markup would be calculated by comparing the variable costs for the AEPCO movement in 2010 and 2011 using the 2010 and 2011 URCS that include the asset markup and the revised 2010 and 2011 URCS that exclude the asset markup; (3) one quarter of the incremental cost determined in Step 2 above would be added to the variable costs calculated in Step 1 above to determine the jurisdictional threshold rate. For future years, this methodology could be used to ensure that an increasing amount of the asset markup is reflected in BNSF's variable costs over the transition period.

We expect that it will be necessary to discuss these issues in person. Please advise when you are available to discuss. Tony

From: Robert Rosenberg [<mailto:rdr@sloverandloftus.com>]
Sent: Wednesday, September 11, 2013 1:14 PM
To: LaRocca, Anthony; Mike Rosenthal (mrosenthal@cov.com); Louise A. Rinn [LARINN@up.com]
(LARINN@up.com)
Subject: AEPCO prescription/rates and BNSF acquisition markup

Tony, Mike, and Lou Anne:

The STB's July 24, 2013 decision directs AEPCO and Defendants BNSF and UP to confer on approaches to reinstating the rate prescription and to advise the STB by September 23, 2013. Please consider this note as initiating the discussion. We would be pleased to confer by telephone, but this matter has enough parts that we thought an email would be the better way to tee things up.

The STB has directed BNSF to file corrected R-1 reports for 2010-2012 by September 23, 2013. We expect that the STB will then prepare the corrected URCS formulas for both BNSF and the Western Region (SWRR) for 2010-2011 and the URCS formulas for 2012. Since the 2010 URCS formulas were used to calculate AEPCO's reparations for 2010-2011, we expect that the corrected 2010 URCS formulas will be used to calculate additional reparations due AEPCO for 2010 and 2011. Since the 2010 URCS formulas were also used to calculate

AEPCO's rates for 2012 and the first weeks of 2013, the corrected 2010 URCS formulas will also be used to calculate additional reparations due AEPCO for 2012 and the first weeks of 2013. Since the 2011 URCS formulas were used to calculate AEPCO's rates for the remainder of 2013, the corrected 2011 URCS formulas will be used to calculate additional reparations due AEPCO for the remainder of 2013 and the first weeks of 2014. The reparations for 2011-2014 will include interest. Assuming the 2012 URCS formulas are available on a timely basis, they will be used to calculate AEPCO's rates for the remainder of 2014 and the first weeks of 2015. If they are not available on a timely basis, it may be necessary to continue to utilize the 2011 URCS formulas, subject to additional reparations when the correct URCS formulas become available.

We understand that BNSF will begin phasing-in the acquisition write-up with the 2013 R-1. If so, we would expect one-quarter of the write-up to be reflected in the 2013 URCS formulas, which would be expected to be reflected in AEPCO's rates after the first few weeks of 2015. The 2014-2016 URCS formulas will follow in turn for use during 2016-2018.

We do not view any of the above as altering the prescription, which is, and remains, at the jurisdictional threshold of 180% of variable costs. Instead, we view the corrected R-1 reports as resulting in corrected variable costs. Also, we recognize that BNSF and UP implemented proportional rates starting January 1, 2012. Accordingly, the corrected URCS formulas will apply only to the BNSF rates starting that date, contingent upon the outcome of AEPCO's appeal. (We note that AEPCO's appeal could also result in the non-use of the Western Region URCS formula for the SWRR segment.) We believe the report to be filed with the STB should be from AEPCO and both defendants.

If the carriers believe that "refunds" is a more appropriate term than "reparations," please let us know. In addition, please let us know if the carriers believe it necessary to obtain a formal STB order directing the payment of the additional reparations/refunds. Regardless, an order reinstating the prescription that was temporarily lifted by the January 20, 2012 decision also appears to be necessary.

We look forward to hearing from you.

Robert

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LaRocca, Anthony

From: LaRocca, Anthony
Sent: Wednesday, September 18, 2013 12:08 PM
To: Robert Rosenberg (rdr@sloverandloftus.com)
Cc: Mike Rosenthal (mrosenthal@cov.com); Sipe, Samuel
Subject: AEPCO

Robert: You asked me to clarify the approach that BNSF is proposing for adjusting BNSF's prescribed rates in 2014-2018 to account for the increasing amount of the asset markup that BNSF is entitled to reflect in its variable costs. My September 13 e-mail to you described the approach that we propose for 2013, when BNSF is entitled to account for 25% of the asset markup. In 2014, BNSF is entitled to account for 50% of the asset markup as part of the four-year transition to a full recognition of the asset markup. The variable cost calculations for 2014 will be based on the 2012 URCS, which will be the most current available URCS. However, the 2012 URCS will not include any effect of the markup. My September 13 e-mail described the methodology for determining the variable cost associated with the asset markup (using the 2010/2011 URCS with and without the asset markup). For 2014, one-half of that markup-related variable cost would be added to the BNSF variable costs determined using the 2012 URCS to ensure that one-half of the asset markup is accounted for in 2014. For 2015, the BNSF variable cost calculations will be based on the BNSF 2013 URCS, which will include 25% of the asset markup. However, in 2015, BNSF is entitled to account for 75% of the asset markup as part of the transition to full recognition of the asset markup. Therefore one-half of the markup-related variable cost (determined as described in my September 13 e-mail) would be added to the 2015 BNSF variable costs determined using the 2013 URCS to ensure that 75% of the asset markup is reflected in the jurisdictional threshold rates (25% plus 50%). For 2016, the BNSF variable cost calculations will be based on BNSF's 2014 URCS, which will include 50% of the asset markup. However, in 2016, BNSF is entitled to account for 100% of the asset markup. Therefore one-half of the markup-related variable cost would be added to the 2016 BNSF variable costs determined using the 2014 URCS to ensure that 100% of the asset markup is reflected in the jurisdictional threshold rates (50% plus 50%). For 2017, the BNSF variable cost calculations will be based on BNSF's 2015 URCS, which will include 75% of the asset markup. However, in 2017, like 2016, BNSF is entitled to a full recognition of the asset markup. Therefore one-quarter of the markup-related variable cost would be added to the 2017 BNSF variable costs determined using the 2015 URCS to ensure that 100% of the asset markup is reflected in the jurisdictional threshold rates (25% plus 75%). Finally, BNSF's variable costs for 2018, the last year of the rate prescription, will be based on 2016 URCS, which will fully reflect the asset markup, and no adjustment is required. Please advise if you need further clarification of the proposed methodology. Tony

BNSF URCS Variable Costs for AEPCO Shipments from El Segundo

Source: STB 2010 URCS

<u>Costing Parameter</u>		<u>Movement Input</u>
Railroad	RR	BNSF
Segment Type	SG	OD (Originated & Delivered)
Distance	DIS	280.5
Freight Car Type	FC	Hopper - Open Top General Service (OTG)
Number of Cars	NC	118
Car Ownership	OWN	Private
Commodity	COM	11 (Coal)
Weight per Car (tons)	WT	118.4
Shipment Size	SZ	Unit Train

Total Variable Costs per Shipment: \$52,403

Variable Fuel Costs

<u>Unit Cost</u>	<u>URCS Source</u>	<u>Shipment Service Units</u>	<u>Variable Fuel Costs</u>
0.0011115 per GTM	D3 LN 164 COL 10	5,871,763	\$6,526
3.00901 per LUM	D3 LN 164 COL 20	1,979	\$5,955
0.14007 per SEM (Road)	D3 LN 164 COL 40	509.2	\$71
0.43618 per SEM (Yard)	D4 LN 135 COL 10	509.2	\$222

Total Variable Fuel Costs per Shipment: \$12,775

Fuel Portion of Variable Costs for AEPCO Shipments: 24.4%