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May 31, 2006

BY HAND DELIVERY

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

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

Dear Secretary Williams:

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

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

Sincerely,

John H. LeSeur

cc: Counsel for BNSF
Parties to Service List

BEFORE THE
SURFACE TRANSPORTATION BOARD

MAJOR ISSUES IN RAIL RATE CASES)	216657 Ex Parte No. 657 (Sub-No. 1)
WESTERN FUELS ASSOCIATION, INC. and BASIN ELECTRIC COOPERATIVE, INC. v. BNSF RAILWAY COMPANY)	STB Docket No. 42088 216658

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

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Dated: May 31, 2006

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

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

Western Fuels Association, Inc. ("WFA") and Basin Electric Power Cooperative, Inc. ("Basin Electric")[1] join in the Reply Comments filed by the Coal Shippers.[2] WFA/Basin file these Additional Reply Comments and in support hereof state as follows:

PREFACE

The Board stated at the outset of the Ex Parte No. 657 proceeding that this proceeding was "not intended to offer a forum for discussion of pending cases." Rail

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

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

Rate Challenges Under the Stand-Alone Cost Methodology, STB Ex Parte No. 657 (STB served Feb. 16, 2005) at 2. However, that is exactly what this proceeding has become.

In its Ex Parte No. 657 (Sub No. 1) notice,[3] the Board deliberately commingled the pending Western Fuels case[4] with the instant proceeding, inter alia, by requiring WFA/Basin to "resubmit" evidence it had previously tendered in Western Fuels concerning Stand-Alone Railroad ("SARR") rate relief methodologies, SARR rate divisions, SARR operating cost forecasts, SARR discounted cash flow ("DCF") calculations and jurisdictional threshold variable cost issues. See Notice at 2-3.

BNSF Railway Company ("BNSF") has also re-submitted much of its Western Fuels case evidence on the above-referenced topics. Many other commenters also address issues raised in Western Fuels. As a result, this proceeding has largely turned into an industry-wide rulemaking proceeding to address case-specific issues raised in the pending Western Fuels case. These issues could – and should – have been resolved in Western Fuels – not these proceedings.[5] In the Additional Reply Comments that follow, WFA/Basin address specific comments made by BNSF concerning the forced interaction of the instant proceeding with the pending Western Fuels case.

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[3] Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub No. 1) (STB served Feb. 27, 2006) ("Notice").

[4] Western Fuels Association, Inc. and Basin Electric Cooperative, Inc. v. BNSF Ry. Co., STB Docket No. 42088 ("Western Fuels").

[5] See WFA/Basin Additional Opening Comments at 29-30.

I.
RATE RELIEF METHODOLOGY

BNSF argues that the Board cannot apply its proposed new rate relief methodologies – the Maximum Contribution Methodology ("MCM") or the Maximum Mark-up Methodology ("MMM") – in the pending Western Fuels case. According to BNSF, such methodologies can only be applied in cases where the record shows a carrier has "gam[ed]" the Board's percent reduction method by setting tariff rates "that are not commercially sustainable."[6] BNSF further opines that there is no evidence in the Western Fuels record showing that its' tariff rates are not "commercially sustainable." Id.

BNSF's gaming contentions are wrong. The flaw in the Board's percent reduction method has nothing to do with "sustainable" rates. Instead, as WFA/Basin demonstrated in Western Fuels, the problem with the Board's percent reduction method is that it unlawfully permits the defendant carrier to dictate the maximum rate prescribed by the Board because "whatever [tariff] rate the carrier sets (high, low or in between) dictates the regulatory answer."[7] This result is unlawful because Congress has directed that the Board – not the railroad industry – set maximum rates. See 49 U.S.C. §10701(d)(1).

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[6] BNSF Opening Comments at 43.

[7] WFA/Basin Additional Opening Comments at Exhibit IA, p. III-H-12 (reproducing portions of WFA/Basin's Opening Evidence (Public Version) in STB Docket No. 42088).

Also, as WFA/Basin demonstrated in the Western Fuels case, there can be no doubt that BNSF has decided to exploit the percent reduction process to obtain higher and higher coal rates – all with the blessing of the STB under the percent reduction method. This forced march to higher and higher rail rates is readily observed in the STB's recent PRB coal rate case dockets. As shown in Reply Table I below, progressively higher challenged common carrier rates have inevitably led to higher percent reduction answers.

Reply Table I **Recent STB PRB** **Coal Case Results**		
Case/Year Decided	Representative Base Common Carrier Rate Challenged (Mills and R/VC Ratio)	Corresponding SAC Rate Under % Reduction (Mills and R/VC Ratio)
WPL/UP – 2002	11.5/193%	9.8/165%
TMPA/BNSF – 2003	13.5/199%	13.1/193%
Xcel/BNSF – 2004	24.2/302%	20.2/252%

In Western Fuels, WFA/Basin asked the Board to apply the Reasonable Allocation Method ("RAM") or, alternatively, the Reduced Mark-Up Method, to set maximum rates.[8] WFA/Basin make the same request in the instant proceeding. However, if the Board disagrees, the Board is not precluded from properly applying the MCM/MMM methodologies in the pending Western Fuels case. See WFA/Basin Additional Opening Comments at 23-24.

[8] See WFA/Basin Additional Opening Comments at Exhibits IA and IB.

The alternative methodologies submitted by WFA/Basin, RAM and Reduced Mark-Up, and those proposed by the Board, MMM/MCM, all share one common trait; they are intended to minimize or eliminate the principal problem with percent reduction – i.e., the carrier's starting tariff rate dictating the maximum SAC rate. Also, as WFA/Basin explained in their Additional Opening Comments, each of the methodologies can be fairly implemented using the existing record evidence in Western Fuels. Id. at 23. Accordingly, the Board is not precluded from applying any of these methodologies in the pending Western Fuels case.

II. DIVISIONS METHODOLOGIES

In the Western Fuels case, BNSF proposed setting divisions using an "avoidable cost" methodology. BNSF proposes the same methodology in this proceeding for application in the pending Western Fuels case. See BNSF Opening Comments at 48-53.

The Board should reject BNSF's "avoidable cost" divisions methodology for the reasons set forth in WFA/Basin's Opening and Rebuttal submissions in the Western Fuels case[9] and for the reasons set forth in the Coal Shippers' Opening and Reply Comments. As explained in these filings, BNSF's avoidable cost divisions methodology is fundamentally inconsistent with the Coal Rate Guidelines, was properly

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[9] Public portions of this evidence are appended in Exhibit 1A and 1B to WFA/Basin's Additional Opening Comments.

rejected in Nevada Power II[10] and subsequent decisions, and produces impermissibly low SARR divisions.[11]

Nor should the Board adopt BNSF's proposed Average Total Cost ("ATC") divisions methodology. As the Coal Shippers demonstrate in their Opening and Reply Comments, the ATC methodology is fatally flawed in numerous respects – as even the railroads concede.[12] Also, as WFA/Basin demonstrated in their Additional Opening Comments, if the Board does adopt ATC for use in future cases – which it should not – it would be fundamentally unfair to retroactively apply this methodology to the pending Western Fuels case.[13] Instead, the Board should apply the MSP method to set divisions in Western Fuels – the method the Board has used in the last ten maximum rate cases involving cross-over traffic. See WFA/Basin Additional Opening Comments at 18-19, 25-28.

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[10] See Bituminous Coal – Hiawatha Utah to Moapa, Nevada, 10 I.C.C. 2d 259, 268 (1989).

[11] See WFA/Basin Additional Opening Comments at Exhibit 2B, pp. II-A-32 to 41.

[12] See Union Pacific Railroad Company Opening Comments at 25 ("[t]he Board's ATC proposal introduces into the maximum rate determination process the same type of arbitrary, economically unprincipled approach that courts have repeatedly rejected.")

[13] See WFA/Basin Additional Opening Comments at 25-28.

III.
INDEXING SARR OPERATING COSTS

In Western Fuels, BNSF argued that the involved SARR, the Laramie River Railroad ("LRR"), would achieve no productivity gains through its first ten years of existence and achieve only marginal productivity gains thereafter. Based on these assertions, BNSF proposed a hybrid index to adjust the LRR's operating expenses that reflected no productivity gains by the LRR in its first ten years and reflected only marginal productivity gains thereafter. In the instant proceeding, BNSF resubmits the same hybrid index it proposed in Western Fuels and resubmits the same evidence in support of this index that it presented in Western Fuels.[14]

WFA/Basin presented substantial evidence in the Western Fuels case demonstrating that the LRR would enjoy far greater productivity improvements than the minimal gains BNSF projected in Western Fuels. The public version of this evidence has been resubmitted in the instant proceeding.[15] The Board should accept WFA/Basin's evidence in this proceeding, as it is clearly correct, and reject BNSF's contrary evidence. Also, in Western Fuels, WFA/Basin urged the Board to adopt the 0.59 RCAF-U index to forecast operating costs in the Western Fuels case. WFA/Basin make the same request

[14] See BNSF Opening Comments at 14-15; V.S. Baranowski at 2-17.

[15] See WFA/Basin Additional Opening Comments at Exhibits 3A and 3B.

here.[16] The Board should apply the 0.59 RCAF-U index because it properly, and conservatively, captures productivity gains the LRR will experience over the twenty-year DCF period. Alternatively, WFA/Basin support the use of the SARR operating cost forecast procedures set forth in the Coal Shippers' Opening Comments. Id. at 88.

IV.
DCF PERIOD

BNSF contends that the Board should utilize a twenty-year DCF analysis in Western Fuels. However, BNSF argues the Western Fuels prescription should be limited to only ten years. See BNSF Opening Comments at 70-71.

In prior cases, the Board has consistently utilized a twenty-year DCF period to prescribe rates for twenty years, not ten years. See Wisconsin Power & Light Co. v. Union Pacific R.R., STB Docket No. 42051 (STB served May 14, 2002) at 22; FMC Wyoming Corp. v. Union Pacific R.R., STB Docket No. 42022 (STB served May 12, 2000) at 185-99; Public Service Company of Colorado d/b/a Xcel Energy v. Burlington Northern and Santa Fe Ry., STB Docket No. 42057 (STB served Jan. 19, 2005) at 4. WFA/Basin relied on this precedent when it submitted its request for a twenty-year rate prescription (starting in 4Q04). Fundamental fairness dictates that the Board not retroactively reduce the Western Fuels rate prescription from twenty years to ten years.

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[16] See id. at 28-29.

V.
VARIABLE COSTS

BNSF proposes that the Board should "in the first instance" calculate the jurisdictional threshold in Western Fuels using system average costs subject to two exceptions: (i) the Board should use the parties' agreed-upon traffic and operating characteristics and (ii) BNSF should be permitted to make additional adjustments to system average costs, at the end of the case, if the Board sets a maximum rate close to the jurisdictional threshold calculated using system-average costs. See BNSF Opening Comments at 60-68.

BNSF obviously wants it both ways – it wants to use system average unit costs if it helps BNSF but not if it hurts BNSF. That is not fair. Instead, the Board should calculate the jurisdictional threshold in Western Fuels using WFA/Basin's adjusted URCS cost calculations. See WFA/Basin Additional Opening Comments at 29.

VI.
OTHER

BNSF makes several other arguments in its Comments that repeat the same misguided arguments it made in Western Fuels:

A. Cross-Subsidy Contentions

BNSF argues that traffic moving entirely north of Donkey Creek should be eliminated from the LRR because this traffic is allegedly "cross subsid[izing]" other LRR traffic.[17] BNSF's cross-subsidy claim assumes that a cross-subsidy exists when SARR revenues for a SARR segment exceed SARR costs. As WFA/Basin explained in detail in Western Fuels, the Board properly rejected BNSF's proffered cross-subsidy test in PPL. See PPL Montana, LLC v. Burlington Northern and Santa Fe Ry., STB Docket No. 42054 (STB served Aug. 20, 2002) at 9-10 (rejecting "BNSF's proposed standard for limiting the revenue contribution from cross-over traffic in excess of SAC").[18] The Board should adhere to this settled rule in Western Fuels.

B. Commercial Reasonableness

BNSF also repeats the claims it made in Western Fuels that the draconian rate increases BNSF has unilaterally imposed on the Laramie River Station ("LRS") traffic constitute a "commercially viable" exercise. BNSF Opening Comments at 46. In fact, as WFA/Basin demonstrated in their Opening and Rebuttal evidence in Western Fuels, BNSF's pricing actions were a raw exercise of monopoly power designed and intended to produce an inflated STB-prescribed rate on the LRS traffic. WFA/Basin's evidence also showed that BNSF's pricing actions were clearly intended to be punitive:[19]

- Between 1984 and September 2004, BNSF provided PRB-to-LRS service under a contract. This contract was a highly lucrative one for BNSF. BNSF's

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[17] See BNSF Opening Comments, V.S. Klick at 31-32.

[18] See also WFA/Basin Rebuttal Narr. at III-A-66 to 67 and WFA/Basin Final Brief at 10.

[19] See WFA/Basin Final Brief at 2-3 (using then-available forecasts).

average revenue-to-variable cost ("R/VC") ratios on the LRS contract traffic exceeded 200% and BNSF earned profits of over $311 million during the twenty-year contract term.

- BNSF's tariff rate increases initially more than doubled the expiring LRS contract rates and the more-than-doubled rates will more-than-double again over the twenty-year DCF period. No coal shipper has ever been faced with percentage increases of this magnitude.

- BNSF's massive rate increases translate into massive profit increases for the high-volume LRS traffic. During the twenty-year DCF period, the total profit increase is over $1 billion. No western coal shipper has ever been faced with payment increases of this magnitude.

- BNSF's system-average R/VC ratio in 2004 equaled 131%. The system-average R/VC ratio BNSF needed to be considered revenue adequate in 2004 equaled 144%. BNSF's initial 4Q04 tariff rates produced average LRS R/VC ratios of 478%. These averages will increase to 649% in 2007 and, by the end of the DCF period, will exceed 847%.

- BNSF's system-average rates for coal per revenue ton-mile equaled 9.6 mills in 2004. BNSF's initial 4Q04 LRS tariff rates (with surcharges) equaled 38.2 mills. These tariff rates will increase to 44.5 mills in 2007 and, by the end of the DCF period, will exceed 88.0 mills.

C. **<u>Other Contentions</u>**

BNSF repeats many other arguments it presented in Western Fuels. WFA/Basin will not attempt to respond to all of BNSF's other contentions here other than to note all of the arguments BNSF made in Western Fuels are addressed by WFA/Basin in the Western Fuels docket.

Respectfully Submitted,

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Dated: May 31, 2006

CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of May, 2006, I caused a copy of the foregoing Additional Reply Comments to be served by hand delivery on counsel for BNSF, as follows:

Samuel M. Sipe, Jr.
Anthony J. LaRocca
David F. Rifkind
Steptoe & Johnson, L.L.P.
1330 Connecticut Avenue, N.W.
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I also caused copies of these Additional Reply Comments to be served by U.S. First Class mail on all other parties on the Board's Ex Parte No. 657 (Sub-No. 1) service list.

Peter A. Pfohl

Peter A. Pfohl