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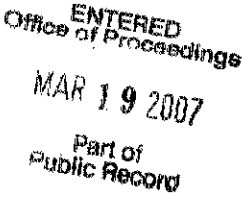
Via HAND DELIVERY



The Honorable Vernon A. Williams
Secretary
Surface Transportation Board

Washington, DC 20423

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

Dear Secretary Williams:

Enclosed are an original and ten copies of the Reply Third Supplemental Evidence of BNSF Railway Company ("BNSF"). Also enclosed are three CDs containing an electronic version of BNSF's Reply Supplemental Evidence and three DVDs containing electronic workpapers supporting BNSF's filing. The electronic workpapers should be treated as Highly Confidential subject to the protective order in this case.

Please date stamp the extra copy of this letter and return it with our messenger.

Sincerely,

Carolyn D. Clayton
Counsel for BNSF Railway Company

Enclosures

cc: Counsel for Complainant

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 41191 (Sub-No. 1)

AEP TEXAS NORTH COMPANY

v.

BNSF RAILWAY COMPANY

REPLY THIRD SUPPLEMENTAL EVIDENCE OF BNSF RAILWAY COMPANY

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March 19, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. 41191 (Sub-No. 1)

AEP TEXAS NORTH COMPANY V. BNSF RAILWAY COMPANY

REPLY THIRD SUPPLEMENTAL EVIDENCE OF BNSF RAILWAY COMPANY

I. INTRODUCTION

In its November 8, 2006 Order (*"November 8 Order"*) in the above captioned proceeding, the Surface Transportation Board ("Board") ordered the parties to submit supplemental evidence needed for the implementation of the Stand-Alone Cost ("SAC") methodologies adopted by the Board in its October 30, 2006 Decision in Ex Parte No. 657 (Sub-No. 1) (*"October 30 Decision"*).[1] The *November 8 Order* instructed the parties to (1) submit variable-cost and jurisdictional-threshold calculations for the issue traffic using unadjusted Phase III URCS costs; (2) develop revenue allocations for cross-over traffic using the Average Total Cost ("ATC") methodology; and (3) calculate the variable costs for all movements in the SARR traffic group using the URCS Phase III movement costing program for use in applying the Maximum Mark-up Methodology ("MMM") for determining maximum rates. AEP Texas filed its Opening Third Supplemental Evidence on these three issues ("AEP Op. Third Supp. Evid.") on February 16, 2007. In accordance with the schedule set out in the Board's November 22, 2006 decision, BNSF Railway Company ("BNSF") hereby submits its Reply to AEP Texas' Opening Third Supplemental Evidence.

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

BNSF has reviewed AEP Texas' implementation of the three methodological changes adopted in Ex Parte No. 657 (Sub-No. 1). For the most part, AEP Texas has followed the procedures established by the Board and BNSF accepts AEP Texas' evidence, with the exception of a few instances where AEP Texas' calculations or methodologies are erroneous or inappropriate, as discussed below.

II. URCS VARIABLE COSTS AND JURISDICTIONAL THRESHOLD

A. The Board Has Already Addressed AEP Texas' Arguments Relating to the Use of Unadjusted System-Average URCS Costs in Establishing the Jurisdictional Threshold

A significant portion of AEP Texas' third supplemental evidence focuses on its objection to the Board's decision to discontinue the use of movement-specific adjustments to URCS variable costs in developing the incumbent's variable costs for jurisdictional-threshold purposes. In particular, AEP Texas challenges the Board's application of the changed policy to this case, which was pending at the time the Board issued its February 27, 2006 Notice of Proposed Rulemaking in Ex Parte No. 657 (Sub-No. 1) ("*NPRM*"). AEP Texas had the opportunity to address that question in Ex Parte No. 657 and in fact did so. This filing of supplemental evidence is not the proper avenue for arguing once again over the merits of the Board's *October 30 Decision.* Therefore, BNSF will address only briefly the points that AEP Texas raised in its supplemental evidence.

First, AEP Texas argues that the Board's conclusion in its *October 30 Decision* that "eliminating movement-specific adjustments means an end to '[t]he immense costs and complexity of such adjustments to URCS . . .'" does not apply to this case. AEP Op. Third Supp. Evid. at 7-8, citing *October 30 Decision* at 51. AEP Texas contends that because the record in this proceeding was already closed when the rulemaking proceeding was opened, the parties have already incurred the expense that was the focus of the Board's concern. *Id.* AEP

Texas' objection is an oversimplification of the Board's decision. In its *October 30 Decision,* the Board concluded that after considering all the comments and arguments, and for all the reasons cited in its *NPRM,* the costs, burden and complexity created by movement-specific adjustments are not justified because they do not improve the variable cost results and, indeed, introduce distortions that undermine any movement-specific cost calculation. *October 30 Decision* at 50-56. In its *NPRM* the Board noted that years of experience with movement-specific adjustments failed to show that such adjustments provide more reliable results than system-average URCS costs. *See NPRM* at 23-27. And, indeed, in its final decision, the Board concluded there are fundamental distortions created by movement-specific calculations. *October 30 Decision* at 53-54. Moreover, as the Board noted in its *NPRM,* the use of movement-specific adjustments does not appear to be consistent with the statutory language of 49 U.S.C. §10707(d)(1)(B) that a carrier's variable costs "shall be determined only by using such carrier's unadjusted costs, calculated using the Uniform Rail Costing System . . . with adjustments specified by the Board." *NPRM* at 22 (Board's emphasis). The use of system-average URCS is more in line with the Board's policy to use URCS as the "general purpose costing system for all regulatory purposes." *Id.* at 27 (Board's emphasis).

AEP Texas further contends that the Board's departure from its prior precedent supporting movement-specific adjustments to URCS lacks evidentiary support. AEP Op. Third Supp. Evid. at 12-13. But as the Board noted in its *October 30 Decision,* "[t]he agency has the authority to depart from prior precedent so long as it offers a reasoned analysis indicating that prior policies and standards are being deliberately changed." *October 30 Decision* at 33, n. 81 *citing National Rural Elec. Coop. Ass'n v. SEC,* 276 F.3d 609, 615 (D.C.Cir. 2002); *Greater Boston Tel. Corp. v. FCC,* 444 F.2d 841, 852 (D.C. Cir. 1970). Here, there is no question that

the Board put all parties on notice that it intended to change certain of its policies and offered a reasoned explanation for the new methodologies both in its *NPRM* and in its final decision.[2]

Third, AEP Texas claims that the use of unadjusted system-average URCS is particularly inappropriate here where AEP Texas has relied on the prior precedent in the preparation of its case. *Id.* at 8. In its *NPRM*, the Board clearly stated that it was reconsidering its position on allowing movement-specific adjustments to URCS variable costs and specifically invited the parties in the two pending cases to address the issue of application of that policy to their respective cases. After considering all comments, including those submitted by AEP Texas, the Board concluded that disallowing movement-specific adjustments in the pending cases would help "establish an unbiased and accurate result." *October 30 Decision* at 76. The Board specifically found that as rate prescriptions imposed in the pending cases "could in theory extend for almost two decades," allowing movement-specific adjustments in those cases "would perpetuate a flawed approach long into the future." *Id.* The arguments AEP Texas raises in this case already have been fully addressed and found unpersuasive by the Board in Ex Parte No. 657 and in the Board's denial of AEP Texas' petition for reconsideration of the Board's proposed application of the changes to pending cases.[3]

AEP Texas further contends that system-average URCS costs are less accurate and less reliable than movement-specific costs and it purports to demonstrate this by comparing the 1Q07 URCS system-average costs for the issue traffic with the 4Q95 movement-specific costs

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[2] While the Board's *October 30 Decision* is currently under review on the merits of the changes, the Board's authority to refine its SAC methodology, and its discretion to do so either on a case-by-case basis or through a rulemaking, are well settled.

[3] *See Ex Parte No. 657 (Sub-No. 1)* (served April 14, 2006).

developed and accepted in *West Texas*[4] indexed to 1Q07. AEP Op. Third Supp. Evid. at 13 and Exhibit OTS-1. But that argument is circular because it inherently rests on the assumption that the original movement-specific costs were more accurate than URCS system-average costs and further assumes that indexing a prior year's costs produces a more accurate result than the use of a current year's URCS costs. While AEP Texas' analysis shows that system-average URCS costs produce higher variable costs than movement-specific costs, it provides no evidence that such URCS costs are inaccurate or unreliable.

B. Implementation of URCS System-Average Variable Costs

In its supplemental evidence, AEP Texas calculated the variable costs of the issue movements for each historic period through 2005 using the URCS Phase III program and the nine specific input factors, as directed by the Board in its *November 8 Order*. AEP Texas indexed the variable costs for each year's URCS (*i.e.*, 2000 through 2005) to quarterly levels within each year, and also indexed the 2005 URCS costs to the appropriate levels for each quarter from 1Q06 through 1Q07.

BNSF accepts the inputs that AEP Texas used in its calculations, although the descriptions in its narrative are not completely accurate. For example, AEP Texas stated that for two input categories – cars-per-train and tons-per-car – "[t]he parties previously stipulated to the number . . . for each of the relevant time periods." AEP Op. Third Supp. Evid. at 16. As clarification, AEP Texas used the stipulated numbers for the historical periods through 2003, and updated the inputs for developing the variable costs for the more recent period by relying upon the freight bills from 2004-2006 for the cars-per-train and tons-per-car inputs. The historical

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[4] *West Texas Utilities Company v. Burlington N.R.R. Co.*, 1 S.T.B. 638 (1996), *aff'd sub nom. Burlington Northern Railroad Company v. S.T.B.*, 114 F.2d 206 (D.C. Cir. 1997). West Texas was a predecessor of AEP Texas.

values that AEP Texas used were consistent with the parties' stipulations. BNSF also accepts the inputs developed for the 2004-2006 period.[5]

BNSF also accepts AEP Texas' indexing of the 2005 base-year URCS variable costs to 1Q06 through 1Q07, with one exception. For the fuel component of Phase III variable costs, AEP Texas incorrectly used the AAR Fuel RCAF-component index. When AEP Texas filed its variable cost evidence in this case in 2004, it relied upon the actual BNSF fuel costs taken from BNSF Investors' Reports to index fuel costs. *See* AEP Texas Opening Workpaper "BN02 Index Open.123." In the technical conference held after the filing of opening evidence, the parties stipulated to the indices that would be used to index variable costs. One of the stipulations was that the parties would use the BNSF-specific index for fuel costs. *See* May 5, 2004 letter to David Konschnik from Kelvin Dowd and David Rifkind, counsel for AEP Texas and BNSF, respectively, included as AEP Texas Reply WP 021-022.[6] But in its supplemental evidence, AEP Texas switched to the broader AAR index without even noting that it was abandoning the approach to which the parties stipulated at the technical conference. AEP Texas' objective in switching to the AAR index is obvious, since it creates the appearance that fuel costs have *decreased* by ten percent from 2005 to 1Q07, whereas in fact BNSF's actual fuel costs are *nearly 30% higher* than in 2005, as shown in the table and chart below.

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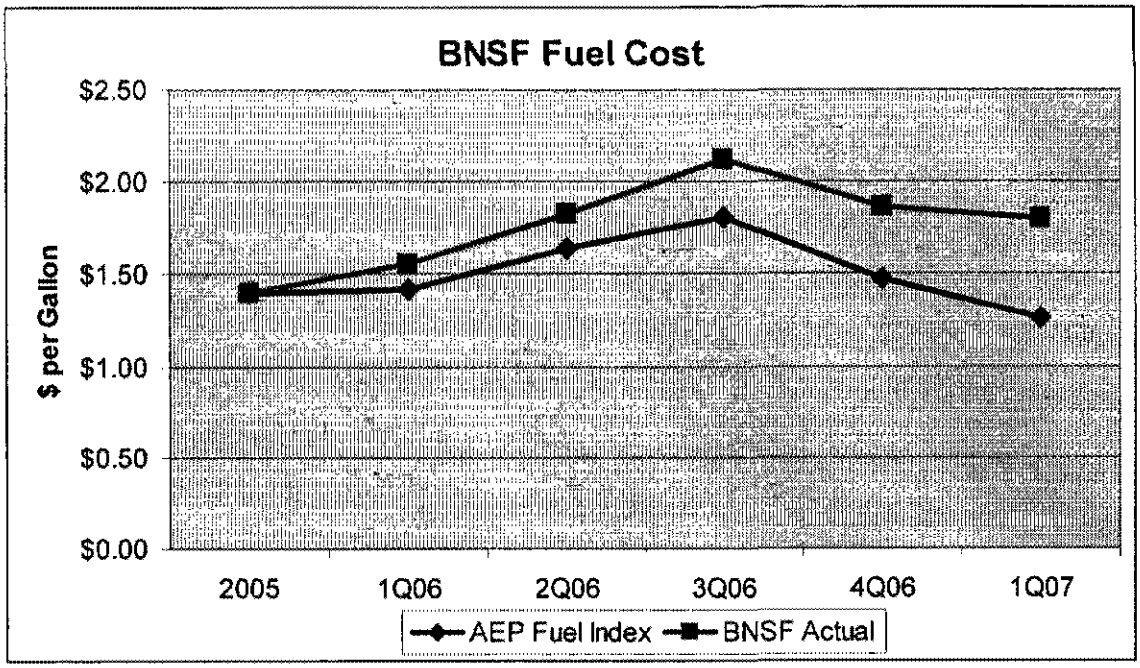
[5] AEP Texas also inaccurately specified the car type as "gondolas" in its narrative, but correctly reflected the historical mix of hoppers and gondolas in developing its variable costs. AEP Op. Third Supp. Evid. at 16; AEP Texas Workpaper "AEPTX Phase III weighted car type.xls"

[6] The parties accepted fuel-index values that matched those in the AEP Texas workpaper identified above, which was based on the actual BNSF fuel costs.

Comparison of AEP Texas Fuel Index to BNSF Actual Fuel Cost

	AEP Fuel Index ($/Gallon)	BNSF Actual ($/Gallon)	AEP Below BNSF Actual
2005	$1.40	$1.40	
1Q06	$1.42	$1.56	-9%
2Q06	$1.64	$1.83	-10%
3Q06	$1.81	$2.12	-15%
4Q06	$1.47	$1.86	-21%
1Q07	$1.26	$1.78	-29%

Source: BNSF Annual 2006 Investors' Report (http://www.bnsf.com/investors/investorreports/4Q_2006_Investors_Report.pdf) and Workpaper "JanFeb07fuel.pdf."



The broader AAR fuel index accounts for the experience of multiple railroads, reflecting different fuel sources and practices, including hedging. BNSF's 2005 URCS costs reflect its extensive hedging benefits in that year. BNSF's hedging benefits decreased in 2006, and therefore BNSF's fuel costs increased substantially from 2005 to 2006 – far more than other

railroads' fuel cost increases. By switching to the broader index, AEP Texas improperly dilutes the significant increase in fuel costs that BNSF actually experienced through 2006, by applying to BNSF's lower 2005 costs an index that is based on the higher 2005 cost of other railroads. AEP Texas' approach therefore fails to capture BNSF's actual fuel price increases from 2005 to 2006. The use of the BNSF fuel costs as reported in the Investors' Reports is a more accurate reflection of BNSF's actual fuel cost experience across its system and as such is consistent with the use of BNSF system-average URCS costs.

AEP Texas' departure from the fuel-indexing methodology agreed upon by the parties and relied upon in recent STB cases[7] was neither necessitated nor authorized by the Board's *November 8 Order* and no such change is warranted. BNSF, therefore, has used the agreed-upon indexing approach to develop the variable costs.[8] BNSF Reply Third Supp. Evid. Workpaper "BN05 INDEX Incl ROI_BNSF Rev.xls."

The differences between variable costs as developed by AEP Texas and BNSF are shown is BNSF Exhibit RTS-1.

III. REVENUE ALLOCATION

In its *November 8 Order,* the Board instructed the parties to develop revenue allocations for cross-over traffic using the Average Total Cost (ATC) methodology, which requires the parties to allocate revenues for cross-over movements based on the incumbent's relative average

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[7] *See e.g.,* Docket No. 42058, *Arizona Electric Power Cooperative v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad Company,* Joint Variable Cost Reply Evidence of BNSF and UP at II-65, filed May 27, 2003 (Public Version) ("The Railroads used BNSF's actual fuel cost per gallon in each quarter"); and AEPCO's Reply Evidence at II-A-101, filed May 27, 2003 (Public Version) ("AEPCO has adopted the Railroads' treatment of the fuel index").

[8] While the impact of AEP Texas' improper change is more significant for the variable costs indexed to 2006-2007, BNSF presents variable costs based on its actual fuel costs for all periods.

total cost per ton for the on-SARR and off-SARR portions of each cross-over movement. To implement ATC, the parties estimate the average total cost (ATC) incurred by the incumbent railroad to haul the traffic over the segment replicated by the SARR, and over the remaining portion of the movement on the residual railroad. *NPRM* at 20. The mechanics of the methodology were described as consisting of three steps:

- First, the railroad's average variable cost (AVC) per ton to haul the traffic over each segment would be estimated using unadjusted URCS.
- Then to estimate the average fixed cost (AFC) per ton of traffic using the various segments, the railroad's system-average fixed cost per route mile would be calculated by dividing the railroad's URCS total fixed costs by the total route miles of track operated by the railroad. This system-average fixed cost per mile could then be combined with the route miles and traffic density of any particular segment of the railroad's network to estimate an AFC per ton associated with that segment.
- The ATC for any particular segment would be the sum of the AVC and the AFC for that segment.

Id. In its *November 8 Order* in this proceeding, the Board further instructed that "we seek a revenue allocation for all movements using a single year's URCS and density information." *Id.* at 3, n. 7.

In its supplemental evidence, AEP Texas purports to follow the instructions in the Board's *NPRM* and its *November 8 Order*. However, BNSF disagrees with AEP Texas' calculations in four areas: (1) AEP Texas erred in calculating ATC by using inconsistent years' data for the densities and URCS costs; (2) In developing the variable cost portion of the revenue allocation methodology, AEP Texas should not have included the costs of a hypothetical interchange that the incumbent does not incur; (3) AEP Texas used a flawed methodology to address fixed costs associated with BNSF trackage-rights miles; and (4) AEP Texas used a single average density for line segments that include segments of varying density rather than

developing the appropriate fixed costs for each density segment within a larger segment. These miscalculations and BNSF's corrections to them are discussed below.

A. Use of Inconsistent Data in Developing Fixed Costs

AEP Texas' first error is its failure to adhere to the Board's intent with respect to the data to be used in developing the average total cost per ton for each movement. AEP Texas used 2000 as its base year, although the SARR operated only two quarters in 2000 and the operating plan and other data for its DCF analysis were based on 2002 data. It then used 2002 and 2004 data to develop the routes and densities for non-coal and coal movements, respectively. Because the routing data for periods prior to 2002 were not available, the parties stipulated that AEP Texas could use the 2002 and 2004 *routing* data to determine the *routes* of non-coal and coal movements for the base year. However, AEP Texas also used the 2002 and 2004 *densities* "as a surrogate" for the base year densities,[9] while continuing to use 2000 "base year" URCS costs.

Using 2000 URCS costs with a different year's density data to develop the fixed cost per ton for all movements, as AEP Texas has done here, is clearly contrary to the Board's intent that the revenue allocations be based on a "single year's URCS and density information." The purpose of the calculation is to identify the incumbent's fixed costs per ton. It would create a meaningless ratio to take the fixed costs from one year and spread those costs over the traffic volumes from another year. The distortions are particularly obvious in this case. Both costs and traffic have increased between 2000 and 2004. AEP Texas took the lowest costs from this time period (2000 URCS costs) and spread those low costs over traffic from the highest density year of the period (2004). The result is a significantly lower fixed cost per ton than would result if the same year's data for both URCS costs and densities (whether 2000 or 2004) were used. Using an

[9] AEP Texas initially stated in its narrative that the parties "agreed to use 2004 densities as a surrogate for the 2000 base year" (AEP Op. Third Supp. Evid. at 20) but corrected that statement in a subsequent letter to the Board.

artificially lower fixed cost per ton, as AEP Texas has done, distorts the results because it artificially reduces the fixed costs on the system and reduces the impact of the density adjustment.[10]

BNSF acknowledges that 2000 density data were not available and therefore does not object to AEP Texas' use of 2004 densities as a surrogate for the base year for density purposes. However, if it chose another year as surrogate for the base year for density purposes, AEP Texas also should have used the corresponding year's URCS costs, consistent with the Board's intent that a single year's density and URCS data be used.[11]

BNSF has corrected AEP Texas' use of inconsistent years' data by using 2004 densities and 2004 URCS costs in the development of the ATC.[12] This approach accommodates the data

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[10] While AEP Texas' understatement of the fixed costs per mile would affect the On-SARR and Off-SARR allocations proportionately, a simple example can show how the inconsistency is biased in the favor of the complainant. Assume a cross-over movement with variable costs of $5 for each of the On-SARR and Off-SARR portions. If the properly calculated fixed costs are $2 On-SARR and $4 Off-SARR – reflecting the higher densities and therefore lower fixed costs per ton for the segments on the SARR – the total costs would be $7 for the On-SARR portion and $9 for the Off-SARR portion. This would result in allocating to the SARR 44% (7 / 16) of the through revenues for the movement. Now consider that the system-wide fixed costs per ton are artificially understated: the relative On-SARR and Off-SARR costs remain in the same proportion, but are now only $1 and $2, respectively. In this scenario, the total costs would be $6 On-SARR and $7 Off-SARR, resulting in a SARR revenue allocation of 46% (6 / 13). As complainants seek to maximize densities in designing their SARRs, the Off-SARR segments are likely to be of relatively lower densities and will receive the higher proportion of fixed costs per ton. As shown in the above example, understating the fixed costs for both the On-SARR and Off-SARR portions will result in overstated revenue divisions for the SARR.

[11] AEP Texas used 2002 density data for the off-SARR portion of non-coal movements and 2004 density data for all other purposes. AEP Texas does not explain why it uses different years' density data for different purposes, but in any event its use of 2002 density data with 2000 URCS suffers from the same flaw as described above.

[12] *See* BNSF Reply Third Supp. Evid. Workpapers "TNR Coal Traf Phase III_BNSF Rev.xls," "gf00ATC_BNSF Rev.xlsx," "gf01ATC_BNSF Rev.xlsx," and "gf02ATC_BNSF Rev.xlsx." BNSF also corrects AEP Texas' use of 2002 densities for the off-SARR portion of non-coal movements. BNSF uses 2004 density and URCS data for all movements. BNSF Reply Third Supp. Evid. Workpaper "TNR_2002_Density_NonCoal_OD_Routing_BNSF Rev.xls."

problem, while at the same time providing a more accurate cost per ton for each segment for use in allocating revenues over those segments.

B. Inappropriate Treatment of Costs for Hypothetical Interchanges

AEP Texas' AVC calculations include costs for hypothetical interchanges between the SARR and the residual railroad. ATC seeks to allocate revenue on cross-over traffic in proportion to the *incumbent's* ATC on each segment of the movement. As the Board explained in its *NPRM*, the ATC methodology involves an estimate of "the average total cost *incurred by the railroad* [*i.e., incumbent*] to haul that traffic over the segment replicated by the SARR and over the segment of the residual railroad." *NPRM* at 20 (emphasis added). But the incumbent incurs no interchange cost on a movement that is treated by the complainant as a cross-over movement in the SAC analysis, so interchange costs should not be included in the ATC calculation.

The URCS costing program assumes that every movement being costed has a cost associated with the beginning and end points of the movement, even if the movement is part of a larger, single line movement. Therefore, when URCS is used to develop the variable costs for two segments of a through movement -- the on-SARR and off-SARR segments -- it automatically inserts interchange costs on both sides of the supposed interchange between the on-SARR and off-SARR segments. This is incorrect. Because the intent is to determine the *incumbent's* relative costs of the line segments, and the incumbent does not incur those interchange costs, no interchange costs should be included. BNSF has corrected this error by removing the URCS variable interchange cost applied to the non-existent interchanges.[13]

[13] BNSF Reply Third Supp. Evid. Workpaper "TNR Coal Traf Phase III_BNSF Rev.xls."

C. Inappropriate Allocation of Fixed Costs on Trackage Rights Segments

A third error in AEP Texas' ATC calculations involves the treatment of trackage-rights miles in allocating system-wide URCS fixed costs. In determining BNSF's system-average fixed cost per route mile, AEP Texas took BNSF's total fixed cost (total cost – total variable cost) and divided that by the total route miles shown in BNSF's 2000 Annual Report Form R-1, which included both owned miles and more than 7,500 miles operated via trackage rights. AEP Op. Third Supp. Evid. at 21. However, when allocating fixed costs to specific segments, AEP Texas allocated no fixed costs at all to trackage-rights segments. AEP Texas Third Supp. Evid. Workpaper "TNR Coal Traf and Rev 0100-0603 Reb_ATC_021607.xls," worksheet "SUMMARY," column "BD." This approach is obviously wrong. It assumes that every mile of road – whether owned or operated via trackage rights – is assigned a portion of BNSF's fixed costs in calculating the cost per mile, but then it assigns no fixed costs to one-quarter of the relevant route miles. Such a methodology clearly understates the incumbent's fixed costs per mile and distorts the ATC calculation. This can be easily illustrated.

Assume that the incumbent operates 30,000 miles of track, of which 24,000 miles are owned and 6,000 are via trackage rights. Assume also that the incumbent has $3 billion in total fixed costs. The average total fixed cost per route mile using AEP Texas' methodology would be $100,000 ($3 billion divided by 30,000 miles). However, fixed costs would be assigned to only the 24,000 owned miles. Thus, the total assignment of fixed costs would be only $2.4 billion ($100,000 x 24,000 miles), thereby understating the fixed costs by $0.6 billion.

One solution to this obvious flaw in AEP Texas' approach would be to correct AEP Texas' calculation of the total fixed cost per route mile by removing the trackage rights miles from the denominator. Thus, the total fixed costs would be distributed over the total miles to which those fixed costs are assigned. In the example given above, that would produce an

average fixed cost per mile of $125,000 ($3 billion divided by 24,000 miles). The resulting cost per mile could then be applied to the owned-mile segments only (24,000), as AEP Texas has done, to recover all $3 billion of system-wide fixed costs.

While this is the simplest way to correct AEP Texas' approach, it is not the most precise way of dealing with trackage-rights segments. Only a portion of the railroad's fixed costs – *i.e.*, "above-the-rail" costs – are incurred on trackage-rights segments. A straightforward alternative would be first to calculate the roadway ("below-the-wheel") fixed costs to be applied only to owned segments, and second to calculate the above-the-rail costs per mile to be applied to all segments (owned and operated via trackage rights).

AEP Texas' approach clearly understates both the fixed cost per route mile and the total recovery of fixed costs in the ATC analysis. In its Reply, BNSF has corrected AEP Texas' calculations using the more precise approach – applying the fixed costs including roadway costs to owned segments and applying only the above-the-rail costs to trackage-rights segments. BNSF also provides the fixed costs calculations using the alternative described previously – removing the trackage rights miles from the denominator.[14]

D. Inappropriate Treatment of Density Segments in Calculating Fixed Costs for On-SARR and Off-SARR Portions of a Movement

For any given cross-over movement, the on-SARR and off-SARR portions of the movement may be comprised of individual segments of varying density. However, in calculating the average fixed costs for the on-SARR and off-SARR portions of a movement, AEP Texas assumes that there are only two segments – the on-SARR segment and the off-SARR segment – and that each segment has only one density – the average density. Although AEP

[14] BNSF Reply Third Supp. Evid. Workpapers "BNSF_2004_Density_BNSF Rev.xls," "TNR_2002_Density_Noncoal_OD_Routing_BNSF Rev.xls" and "TNR_2004_Density_BNSF Rev.xls."

Texas properly defined a "density segment" as a discrete segment of the SARR or residual BNSF system within which the traffic density is consistent,[15] AEP Texas ignores the individual density segments in its calculations of the average fixed cost per ton over the on-SARR and off-SARR portions of a movement. Instead, AEP Texas simply uses an average density across the entire on-SARR or off-SARR portion of the movement. This approach understates the average cost per ton of the on-SARR and off-SARR portions.

The effect of this methodological error can be easily demonstrated. The hypothetical example below assumes that the off-SARR portion of a movement consists of two density segments, a high-density segment of 100 million tons and a low-density segment of 20 million tons. It also assumes that the fixed cost per route mile using URCS data (incumbent's total fixed costs divided by incumbent's total route miles) is $100,000, which would be applied to the mileage for each density segments. It also assumes that the route miles of each of the two density segments are 30. The total fixed cost for each segment would be $3,000,000 ($100,000 x 30 miles). The fixed cost per ton for each segment would be calculated by dividing the total fixed costs by the density, resulting in a fixed cost per ton of $0.03 ($3,000,000 divided by 100,000,000 tons) on the high-density segment and $0.15 ($3,000,000 divided by 20,000,000 tons) on the low-density segment. The total fixed cost per ton for the entire off-SARR segment would be the sum of the two densities, or $0.18.

By way of contrast, the methodology used by AEP Texas does not calculate the fixed cost per ton for each density segment, but rather uses the sum of the route miles of the high and low density segments (30 + 30 = 60 miles) and the average density of the two segments (100 million + 20 million divided by 2 = 60 million) and calculates the fixed cost per ton by dividing the total

[15] For example, a portion of the system that runs from point A to point C via point B, where A-B handles 10 million tons and B-C handles 8 million tons, would be comprised of two density segments. AEP Op. Third Supp. Evid. at 20, fn. 25.

combined fixed cost of $6,000,000 by the *average density* of 60,000,000 to get a fixed cost per ton of $0.10. This methodology understates the fixed cost per ton on the off-SARR movement, resulting in a greater revenue allocation to the SARR.

	Source	Using Individual Segments			Using One "Average" Segment
		High-Density Segment	Low-Density Segment	Total	
1. Fixed Costs per Mile	URCS Data	$100,000	$100,000		$100,000
2. Route Miles	Segment Data	30	30		60
3. Total Fixed Costs	Row 1 x Row 2	$3,000,000	$3,000,000		$6,000,000
4. Density	Segment Data	100,000,000	20,000,000		60,000,000
5. Fixed Cost per Ton	Row 3 / Row 4	$0.03	$0.15	**$0.18**	**$0.10**

In its Reply, BNSF has determined the fixed cost for each individual density segment within the on-SARR and off-SARR segments and summed those costs to develop the total fixed cost per ton for the entire on-SARR and off-SARR segments.[16]

IV. MAXIMUM MARK-UP METHODOLOGY

The *November 8 Order* directs the parties to "calculate the variable cost for all movements (issue and non-issue movements) using the URCS Phase III movement costing program" to support the application of MMM to determine the maximum stand-alone rate. *Id.* at 4. AEP Texas developed the variable costs for all movements for MMM purposes in the same way that it calculated them for the ATC revenue allocation.[17] BNSF agrees that the variable costs should be the same for both purposes, and thus BNSF uses the same variables costs for MMM as it uses for ATC.[18]

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[16] BNSF Reply Third Supp. Evid. Workpaper "BNSF_2004_Density_BNSF Rev.xls," TNR_2002_Density_Noncoal_OD_Routing_BNSF Rev.xls" and "TNR_2004_Density_BNSF Rev.xls."

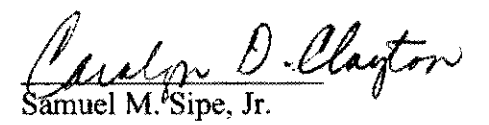
[17] *See* AEP Op. Third Supp. Evid. at 25 and the cited AEP Texas workpapers.

[18] BNSF Reply Third Supp. Evid. Workpaper "TNR Coal Traf and Rev 0100-0603 Reb_ATC_021607_BNSF Rev.xls."

V. CONCLUSION

In this Reply, BNSF has implemented the three new methodologies adopted by the Board in Ex Parte No. 657 (Sub-No. 1), correcting the errors made by AEP Texas in its opening third supplemental evidence as discussed above. The differences between the parties' variable cost calculations are shown in BNSF Workpaper "BNSF Phase III 2005 ALL.xls." The differences between their ATC calculations are set forth in BNSF Reply Exhibit RTS_2. The details of these calculations are set out in the workpapers BNSF submitted with this filing.[19]

Respectfully submitted,



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March 19, 2007

[19] BNSF Reply Third Supp. Evid. Workpaper "BNSF RTS Workpaper Index.xls."

Comparison of Parties' Phase III Variable Costs
1Q05 through 1Q07

Origin	Quarter	AEP Texas Phase III Variable Cost	BNSF Phase III Variable Cost	Difference
(1)	(2)	(3)	(4)	(5)
A. Buckskin Originations				
1.	1Q05	$9.85	$9.96	$0.11
2.	2Q05	$10.25	$10.24	($0.01)
3.	3Q05	$10.44	$10.54	$0.09
4.	4Q05	$10.97	$10.79	($0.18)
5.	1Q06	$10.53	$10.69	$0.16
6.	2Q06	$10.87	$11.08	$0.21
7.	3Q06	$11.04	$11.39	$0.36
8.	4Q06	$10.63	$11.07	$0.44
9.	1Q07	$10.41	$11.00	$0.59
B. Eagle Butte Originations				
10.	1Q05	$10.00	$10.11	$0.11
11.	2Q05	$10.07	$10.06	($0.01)
12.	3Q05	$10.76	$10.85	$0.09
13.	4Q05	$11.30	$11.12	($0.18)
14.	1Q06	$10.85	$11.01	$0.17
15.	2Q06	$11.15	$11.37	$0.22
16.	3Q06	$11.38	$11.75	$0.37
17.	4Q06	$10.95	$11.41	$0.46
18.	1Q07	$10.73	$11.34	$0.61
C. Jacobs Ranch Originations				
19.	1Q05	$10.46	$10.58	$0.12
20.	2Q05	$10.89	$10.88	($0.01)
21.	3Q05	$11.09	$11.19	$0.10
22.	4Q05	$11.65	$11.47	($0.19)
23.	1Q06	$11.18	$11.36	$0.17
24.	2Q06	$11.50	$11.73	$0.23
25.	3Q06	$11.73	$12.11	$0.38
26.	4Q06	$11.30	$11.77	$0.47
27.	1Q07	$11.07	$11.70	$0.63
D. Black Thunder Originations				
28.	1Q05	$10.17	$10.28	$0.11
29.	2Q05	$10.58	$10.57	($0.01)
30.	3Q05	$10.78	$10.88	$0.10
31.	4Q05	$11.32	$11.14	($0.18)
32.	1Q06	$10.87	$11.03	$0.17
33.	2Q06	$11.17	$11.40	$0.22
34.	3Q06	$11.40	$11.77	$0.37
35.	4Q06	$10.98	$11.43	$0.46
36.	1Q07	$10.75	$11.36	$0.61

Comparison of Parties' Phase III Variable Costs
1Q05 through 1Q07

Origin (1)	Quarter (2)	AEP Texas Phase III Variable Cost (3)	BNSF Phase III Variable Cost (4)	Difference (5)
E. Caballo Rojo Originations				
37.	1Q05	$10.60	$10.72	$0.12
38.	2Q05	$11.04	$11.03	($0.01)
39.	3Q05	$11.25	$11.35	$0.10
40.	4Q05	$11.81	$11.62	($0.19)
41.	1Q06	$11.34	$11.51	$0.17
42.	2Q06	$11.66	$11.89	$0.23
43.	3Q06	$11.89	$12.28	$0.38
44.	4Q06	$11.45	$11.93	$0.48
45.	1Q07	$11.22	$11.85	$0.64
F. North Antelope Originations				
46.	1Q05	$9.25	$9.36	$0.10
47.	2Q05	$9.63	$9.62	($0.01)
48.	3Q05	$9.81	$9.90	$0.09
49.	4Q05	$10.31	$10.14	($0.16)
50.	1Q06	$9.89	$10.04	$0.15
51.	2Q06	$10.17	$10.37	$0.20
52.	3Q06	$10.38	$10.71	$0.33
53.	4Q06	$9.99	$10.41	$0.42
54.	1Q07	$9.79	$10.34	$0.56
G. Caballo Originations				
55.	1Q05	$10.23	$10.34	$0.12
56.	2Q05	$10.65	$10.64	($0.01)
57.	3Q05	$10.85	$10.94	$0.10
58.	4Q05	$11.39	$11.21	($0.18)
59.	1Q06	$10.93	$11.10	$0.17
60.	2Q06	$11.25	$11.47	$0.22
61.	3Q06	$11.47	$11.84	$0.37
62.	4Q06	$11.04	$11.51	$0.46
63.	1Q07	$10.82	$11.44	$0.61
H. Cordero Originations				
64.	1Q05	$10.08	$10.19	$0.11
65.	2Q05	$10.49	$10.48	($0.01)
66.	3Q05	$10.69	$10.78	$0.09
67.	4Q05	$11.22	$11.04	($0.18)
68.	1Q06	$10.77	$10.94	$0.17
69.	2Q06	$11.08	$11.30	$0.22
70.	3Q06	$11.30	$11.66	$0.36
71.	4Q06	$10.88	$11.33	$0.45
72.	1Q07	$10.66	$11.26	$0.61

Comparison of Parties' Phase III Variable Costs
1Q05 through 1Q07

Origin	Quarter	AEP Texas Phase III Variable Cost	BNSF Phase III Variable Cost	Difference
(1)	(2)	(3)	(4)	(5)
I. North Rochelle Originations				
73.	1Q05	$9.69	$9.80	$0.11
74.	2Q05	$10.08	$10.07	($0.01)
75.	3Q05	$10.27	$10.36	$0.09
76.	4Q05	$10.79	$10.62	($0.17)
77.	1Q06	$10.35	$10.51	$0.16
78.	2Q06	$10.65	$10.86	$0.21
79.	3Q06	$10.86	$11.21	$0.35
80.	4Q06	$10.46	$10.90	$0.44
81.	1Q07	$10.25	$10.83	$0.58
J. Antelope Originations				
82.	1Q05	$9.83	$9.94	$0.11
83.	2Q05	$10.23	$10.22	($0.01)
84.	3Q05	$10.42	$10.51	$0.09
85.	4Q05	$10.94	$10.77	($0.17)
86.	1Q06	$10.50	$10.67	$0.16
87.	2Q06	$10.80	$11.02	$0.21
88.	3Q06	$11.02	$11.38	$0.36
89.	4Q06	$10.61	$11.05	$0.44
90.	1Q07	$10.39	$10.98	$0.59

Comparison of Parties' Phase III Variable Costs
2Q00 through 4Q04

Origin	Quarter		AEP TX Phase III Variable Cost	BNSF Phase III Variable Cost	Difference
(1)	(2)		(3)	(4)	(5)
A. Buckskin Mine Originations					
1	2Q00		$8.40	$8.69	$0.29
2	3Q00		$8.77	$8.77	($0.00)
3	4Q00		$9.02	$8.94	($0.08)
4	1Q01		$9.29	$9.24	($0.05)
5	2Q01		$9.18	$9.17	($0.01)
6	3Q01		$9.16	$9.20	$0.04
7	4Q01		$9.02	$9.04	$0.02
8	2Q03		$9.53	$9.53	$0.00
9	4Q03		$9.45	$9.41	($0.04)
B. Rawhide Mine Originations					
10	1Q02		$8.97	$9.04	$0.07
11	2Q02		$9.24	$9.24	$0.00
12	3Q02		$9.38	$9.40	$0.02
13	4Q02		$9.53	$9.43	($0.10)
14	1Q03		$9.59	$9.64	$0.05
15	2Q03		$9.63	$9.63	$0.00
C. Eagle Butte Mine Originations					
16	1Q03		$9.41	$9.45	$0.05
17a.	2Q03	117 Cars	$9.20	$9.20	$0.00
17b.	2Q03	128 Cars	$9.20	$9.20	$0.00
18	3Q03		$9.33	$9.33	($0.01)
19	4Q03		$9.32	$9.28	($0.04)
20	1Q04		$9.45	$9.50	$0.05
	2Q04		$9.61	$9.66	$0.05
	3Q04		$9.86	$9.88	$0.02
	4Q04		$10.33	$10.18	($0.15)
D. Jacobs Ranch Mine Originations					
21	2Q00		$7.80	$8.07	$0.27
22	3Q00		$8.57	$8.56	($0.00)
23	1Q01		$9.19	$9.14	($0.05)
24	2Q01		$9.06	$9.05	($0.01)
25	3Q01		$8.78	$8.81	$0.04
26	4Q01		$8.84	$8.86	$0.02
27	1Q02		$8.67	$8.74	$0.07
28	3Q02		$8.95	$8.96	$0.02
29	4Q02		$9.39	$9.29	($0.10)
30	2Q03		$9.50	$9.51	$0.00
E. Black Thunder Mine Originations					
31	1Q01		$8.66	$8.61	($0.05)
32	3Q01		$8.91	$8.95	$0.04
33	4Q01		$8.64	$8.66	$0.02
34	2Q02		$8.94	$8.94	$0.00
35	3Q02		$8.96	$8.98	$0.02
36	4Q02		$9.33	$9.24	($0.09)
37	2Q03		$9.38	$9.38	$0.00
38	4Q03		$9.27	$9.23	($0.04)
39	1Q04		$9.44	$9.49	$0.05
	2Q04		$9.49	$9.54	$0.05
	3Q04		$9.71	$9.73	$0.02
	4Q04		$10.13	$9.99	($0.14)

Comparison of Parties' Phase III Variable Costs
2Q00 through 4Q04

Origin	Quarter	AEP TX Phase III Variable Cost	BNSF Phase III Variable Cost	Difference
(1)	(2)	(3)	(4)	(5)
F. Caballo Rojo Mine Originations				
40	2Q00	$8.37	$8.66	$0.29
41	3Q00	$8.65	$8.65	($0.00)
42	4Q00	$8.92	$8.85	($0.08)
43	1Q01	$9.12	$9.07	($0.05)
44	2Q01	$8.92	$8.91	($0.01)
45	3Q01	$9.11	$9.15	$0.04
46	4Q01	$8.82	$8.84	$0.02
47	2Q03	$9.62	$9.63	$0.00
G. North Antelope Mine Originations				
48	2Q03	$9.05	$9.06	$0.00
49	3Q03	$9.08	$9.07	($0.01)
H. Caballo Mine Originations				
50	2Q02	$9.27	$9.27	$0.00
51	3Q02	$8.96	$8.97	$0.02
52	4Q02	$9.55	$9.46	($0.10)
53	2Q03	$9.27	$9.27	$0.00
I. Cordero Mine Originations				
54	2Q03	$9.12	$9.12	$0.00
J. North Rochelle Mine Originations				
55	3Q02	$9.11	$9.13	$0.02
56	2Q03	$9.12	$9.12	$0.00
57	4Q03	$9.03	$8.99	($0.04)
	4Q04	$9.64	$9.51	($0.14)
K. Antelope Mine Originations				
58	2Q03	$8.89	$8.89	$0.00
59	4Q03	$8.20	$8.17	($0.04)
60	1Q04	$9.10	$9.14	$0.04
L. Belle Ayr Mine Originations				
61	2Q03	$9.58	$9.58	$0.00
M. Dry Fork Mine Originations				
62	2Q03	$9.66	$9.67	$0.00
N. Fort Union Mine Originations				
63	2Q03	$9.61	$9.61	$0.00
O. Clovis Point Mine Originations				
64	2Q03	$9.62	$9.62	$0.00
P. Coal Creek Mine Originations				
65	2Q03	$9.59	$9.59	$0.00
Q. Rochelle Mine Originations				
66	2Q03	$9.49	$9.49	$0.00

TNR Revenue Comparison

Year	SARR Revenues ($ in Millions)		
	AEP Third Supplemental Opening (2-16-07)	BNSF Third Supplemental Reply (3-19-07)	Difference
2000 1/	$389.1	$365.6	($23.6)
2001	$720.5	$674.2	($46.3)
2002	$727.4	$683.5	($43.9)
2003	$702.2	$659.1	($43.2)
2004	$730.7	$692.0	($38.7)
2005	$735.6	$690.8	($44.8)
2006	$762.1	$713.9	($48.2)
2007	$787.3	$730.1	($57.2)
2008	$795.4	$744.8	($50.6)
2009	$820.6	$762.9	($57.7)
2010	$832.8	$744.7	($88.1)
2011	$859.0	$770.0	($89.0)
2012	$899.1	$810.3	($88.8)
2013	$923.3	$826.0	($97.3)
2014	$943.2	$845.5	($97.7)
2015	$955.5	$855.9	($99.6)
2016	$981.1	$879.6	($101.5)
2017	$1,013.3	$907.2	($106.1)
2018	$1,045.9	$936.0	($109.9)
2019	$1,079.6	$965.7	($113.9)
2020	$1,129.3	$1,009.0	($120.2)

1/ Period from June 16, 2000 through December 31, 2000

VERIFICATION

I, Benton V. Fisher, verify under penalty of perjury that I am the same Benton V. Fisher whose Statement of Qualifications appears in Part V of the Narrative Portion of the Reply Evidence of The Burlington Northern and Santa Fe Railway Company (now BNSF Railway Company) filed in this proceeding on May 24, 2004; that I am responsible for Sections II, III and IV of the foregoing Reply Third Supplemental Evidence of BNSF; that I know the contents thereof and that the same are true and correct; and that I am qualified and authorized to file this statement.

Benton V. Fisher

Executed on March 16, 2007.

CERTIFICATE OF SERVICE

I, Carolyn Doozan Clayton, certify that on the 19th day of March 2007, I caused a copy of the foregoing Reply Third Supplemental Evidence of BNSF Railway Company to be served by hand delivery on counsel for AEP Texas, as follows:

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