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August 20, 2007

HAND DELIVERY

The Honorable Vernon A Williams
Secretary
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Re Finance Docket No 42095, Kansas City Power & Light Company v Union Pacific Railroad Company

Dear Mr Williams

Enclosed for filing in the above-referenced docket please find an original and ten copies of Union Pacific's Reply Evidence, along with three electronic copies on 3 5-inch IBM-compatible formatted floppy diskettes

Also enclosed please find three sets of Union Pacific's electronic workpapers on compact discs. The electronic workpapers should be treated as Confidential, pursuant to the Board's Protective Order in this proceeding

An additional paper copy of Union Pacific's Reply Evidence is also enclosed. Please return a date-stamped copy to our messenger.

I thank you for your attention to this matter.

Sincerely

Handwritten signature of Michael L Rosenthal.

Michael L Rosenthal

Enclosures

cc Kelvin J Dowd, Esq (by hand)

BEFORE THE
SURFACE TRANSPORTATION BOARD

220086



KANSAS CITY POWER & LIGHT COMPANY,)

Complainant,)

v)

UNION PACIFIC RAILROAD COMPANY,)

Defendant)

Docket No 42095

UNION PACIFIC'S REPLY EVIDENCE

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)	
Defendant)	
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UNION PACIFIC’S REPLY EVIDENCE

Union Pacific Railroad Company hereby submits its reply evidence in compliance with the Board’s Order served May 4, 2007

I. COUNSEL’S ARGUMENT AND SUMMARY OF EVIDENCE

A. INTRODUCTION

Kansas City Power & Light Company (“KCPL”) has flouted the Board’s decision in *Major Issues in Rail Rate Cases*, STB Ex Parte No 657 (Sub-No 1) (STB served Oct 30, 2006) (“*Major Issues*”) KCPL’s opening evidence contains two alternative variable cost calculations, but neither complies with the Board’s ruling that the “variable costs used in rate reasonableness proceedings will be the system-average variable costs generated by URCS, using the nine movement-specific factors inputted into Phase III of URCS ” *Major Issues*, slip op at 60 Instead, as discussed below, KCPL’s calculations incorporate biased movement-specific adjustments to the URCS Phase III program and fabricated “corrections” to the operating statistics used to develop UP’s URCS The Board should reject KCPL’s variable cost calculations and adopt UP’s

KCPL's opening evidence also contains a spurious claim that UP engaged in an unreasonable practice by refusing to extend the same service commitment to all coal that KCPL might ship to Montrose. As discussed below, UP was not obligated to hold out the same service commitment for all coal shipped by KCPL, and certainly not for substantially more coal than KCPL ever shipped in the past.

The Board should dismiss KCPL's complaint because the challenged rate does not exceed 180 percent of variable costs and therefore UP is not market dominant and because establishing a limit on a special service commitment containing a liquidated damages provision is not an unreasonable practice.

B. KCPL'S VARIABLE COST EVIDENCE IS BIASED AND INACCURATE.

UP's opening evidence contained two alternative variable cost calculations. The first reflected a good-faith effort to apply the Board's decision in *Major Issues*, which rejected arguments that variable cost calculations should include payments to third parties, such as UP's payments to MNA. The second showed how the Board could easily account for the fact that UP's payments to MNA are not captured as costs by URCS, and thus are not included in the costs developed by the URCS Phase III program, by adding the payment amounts to results generated using the Phase III program.

KCPL's opening variable cost evidence was very different from UP's. Disregarding the Board's decision in *Major Issues*, KCPL changed URCS costs by excluding two categories of costs – terminal switching costs and private car payments – that, by KCPL's own admission, “otherwise would be automatically included by the URCS Phase III program.” KCPL Op II-A-20. KCPL also disregarded the Board's decision in *Major Issues* and changed the results produced by the Phase III program by substituting movement-specific railcar tare weights for the system-average value that otherwise would be used by the Phase III program.

See id, II-A-18 to 20¹ Even when KCPL presented its “alternative” variable cost calculations that purportedly complied with the Board’s decision in *Major Issues*, it applied a fabricated “correction” to data in UP’s 2006 Annual Report Form R-1 that improperly reduced UP’s system-average unit costs for switching *See* KCPL Op at I-23 & n 24

In the sections below, UP discusses KCPI.’s variable cost calculations KCPL’s movement-specific adjustments and alteration of UP’s Form R-1 data clearly violate the express terms of the Board’s decision in *Major Issues*

1. KCPL’s Evidence Illustrates How Movement-Specific Adjustments Can Be Misused.

KCPI. adopted a biased approach to its variable cost calculations by making movement-specific adjustments only when they would reduce variable costs KCPL did not make any movement-specific adjustments that would increase variable costs, such as substituting the actual number of locomotives used to move the issue traffic from the Powder River Basin to Montrose, actual ownership costs of the newer AC-powered locomotives used in coal service, or actual maintenance-of-way costs associated with coal traffic² KCPI. also excluded completely an entire category of costs – namely, terminal switching costs – even though UP plainly incurs such costs in moving the issue traffic to Montrose In short, KCPL’s approach was not designed to improve the accuracy of KCPL’s variable cost calculations, rather, it was designed to skew the calculations in its favor

¹ UP has not reviewed the accuracy of the tare weight data submitted by KCPI. *See* Joint Submission of URCS Phase III Operating Characteristics at 3 (June 8, 2007)

² *See* Opening Submission of Union Pacific Railroad Co at 41-42, *Major Issues in Rail Rate Cases*, STB Ex Parte No 657 (Sub-No 1) (STB May 1, 2006)

The result-oriented nature of KCPL's approach is illustrated by KCPL's failure to make a movement-specific adjustment to reflect the actual number of locomotives used to move the issue traffic. KCPL observed that the Phase III program has menus that make it possible to change the locomotive consist size and unit train weight. See KCPL Op at I-16. But while KCPL adjusted the system-average unit train weight to reflect lower, "actual" railcar tare weights, it did not adjust the system-average locomotive consist size to reflect the higher, actual number of locomotives that UP uses to move coal to Montrose. KCPL used the system-average locomotive consist size of 2.90, rather than account for the three locomotives (not including helpers) described in discovery materials produced by UP.³

The biased nature of KCPL's approach is also illustrated by KCPL's decision not to use movement-specific cycle-time data in its variable cost calculations. KCPL asked UP to produce movement-specific cycle-time data after the Board's decision in *Major Issues*.⁴ UP complied with that request to avoid unnecessary disputes.⁵ KCPL then insisted on including cycle-time data in the parties' Joint Submission of URCS Phase III Operating Characteristics, even though they are not among the nine inputs for the Phase III program. KCPL told the Board that "KCPL will use them in its calculations in the interest of accuracy." Joint Submission at 3. But despite its representations to the Board, KCPL did not use the cycle-time data in its opening evidence.

³ See UP Op electronic workpaper "UP_Response7.pdf", see also UP Op at II-3 ("UP supplies three AC locomotives operated in a 2x1 Distributed Power ('DP') configuration in both the loaded and empty direction between the Southern PRB and Montrose.")

⁴ See UP Reply electronic workpaper "KCPL_supplemental_discovery_requests.pdf"

⁵ See UP Reply electronic workpaper "UP_discovery_response.pdf"

Why did KCPL ultimately decide not to use movement-specific cycle-time data in its opening evidence? Because the data eviscerate KCPL's argument for excluding terminal switching costs. Because certain URCS unit costs are assigned on the basis of time, the URCS Phase III program translates route miles and switching activities into hours and minutes. When the translation is applied to the issue traffic's Phase III operating characteristics – which the parties agreed include an origin switch, interchange switches, and a destination switch – the implied round-trip cycle time is approximately 194 hours.⁶ The 194-hour figure is consistent with the cycle times that KCPL included in the Joint Submission. See Joint Submission, Att 1. However, if one assumes that there is no terminal switching, as KCPL did in its opening evidence, the Phase III program indicates that the round-trip cycle time should be approximately 75 hours – which is unrealistically low according to the cycle times that KCPL included in the Joint Submission.⁷ In other words, KCPL apparently decided not to use movement-specific cycle-time data because the data would have undermined its assertion that there was no terminal switching.

UP does not claim that all of the cycle-time difference is attributable to terminal switching activities, but much of it plainly is. Contrary to KCPL's assertion, there are significant terminal switching activities associated with the issue movement, particularly with regard to the interchange between UP and MNA in Kansas City. See UP Op at II-3 to 5. In addition, loading and unloading activities, even on loop tracks, consume more time than line-haul operations over the same number of route miles, and thus generate higher locomotive ownership and crew costs.

⁶ See UP Reply electronic workpaper "URCS cycle.xls"

⁷ UP has not reviewed the accuracy of the cycle-time data submitted by KCPL. See Joint Submission at 3.

on a per-mile basis. KCPL is thus incorrect when it claims that treating loop-track miles as loaded miles is sufficient to account for terminal switching costs. See KCPL Op at I-17.⁸

Terminal switching costs for unit train movements are undoubtedly lower than for non-unit train movements. However, the Phase III program already accounts for the efficiencies typically associated with unit train switching activities by reducing system-average origin and destination switching costs by 75% and system-average interchange switching costs by 50%. Moreover, the Phase III program reduces system-average costs for intermediate switching to zero, which gives UP no credit for the costs it incurs to perform bad-order switching or switching activities performed on KCPL trains at North Platte Yard or elsewhere along the route. See UP Op at II-5. KCPL's effort to reduce UP's switching costs by even more than they are reduced by the Phase III program is plainly contrary to the Board's decision in *Major Issues*.

* * *

KCPL's approach to variable cost calculations, if adopted by the Board, would act as a one-way, downward ratchet and prevent UP from recovering its costs on a system-wide basis. Under KCPL's approach, UP's terminal switching costs could be reduced to zero in

⁸ KCPL also is incorrect when it claims that Board precedent supports treating loop-track miles as loaded miles. See *id.* at I-17. In the cases cited by KCPL, the ICC adopted the shipper's approach as the best evidence in the record, but acknowledged that it would understate switching costs. See *Annual Volume Rates on Coal – Wyo. to Flint Creek, Ark.*, 363 I.C.C. 533, 572 (1979) (“[W]e realize that this approach may result in a slight understatement of costs due to the fact that we are treating the loop track movement as if it were a line-haul movement even though it contains some elements of switching in the movements”). *Increased Rates on Coal, BN, Mont. to Superior, Wis.*, 362 I.C.C. 625, 665 (1980) (same).

KCPL also makes the highly misleading claim that past coal rate cases “routinely exclude terminal switching.” KCPL Op at I-18 (citing *Pub Serv Co of Colo v BNSF Ry*, STB Docket No. 42057 (STB served June 8, 2004)). In those cases, locomotive ownership and crew costs were calculated using actual cycle times and payroll records, which effectively accounted for terminal switching costs on a movement-specific basis – the same movement-specific adjustment that KCPL decided not to make in this case. See e.g. *Pub Serv Co of Colo*, slip op at 127-28.

situations involving below-average switching costs, but UP could never recover more than a system-average allocation in situations involving above-average switching costs. Similarly, UP could not recover costs associated with private car payments unless it paid the shipper a mileage allowance, but even then, UP could never recover more than a system-average allocation of those private car payment costs. KCPL's approach is thus inconsistent with the Board's commitment to using system-average URCS costs and the Phase III program and with the Board's obligation to assist rail carriers in attaining revenue adequacy. *See* 49 U.S.C. § 10704(a)(2)

2. KCPL's "Correction" to UP Switching Costs Is Improper.

In addition to presenting variable cost calculations based on impermissible adjustments to the URCS Phase III program, KCPL presents an alternative set of calculations that includes a fabricated "correction" to UP's switching costs. *See* KCPL Op., Ex. II-A-6. KCPL claims that the correction was necessary because "UP's 2005 and 2006 Form R-1's contain faulty information related to train switching hours." KCPL Op. at II-A-24.

KCPL's "correction" is another impermissible adjustment to UP's system-average URCS costs and thus a collateral attack on the Board's decision in *Major Issues*. This is not an appropriate forum to dispute the accuracy of data contained in UP's Form R-1.

Moreover, KCPL is incorrect to suggest that UP's 2005 and 2006 Form R-1 data regarding train switching hours are unusual or reflect "faulty information." UP's 2005 and 2006 Form R-1 data are consistent with UP's Form R-1 data in past years. UP's 2.1 million switching hours in 2006 and 2.2 million hours in 2005 are not significantly different from the 1.9 million hours that UP reported in 1998 or the switching hours that UP reported between 1998 and 2005.

KCPL argues that UP's train switching data are not in line with data reported by other railroads. *See* KCPL Op. at II-A-25. KCPL, however, does not address the nature or mix of traffic on other railroads as compared with UP, which makes it impossible to engage in any

meaningful comparison of terminal switching data. UP has no basis to comment on the train switching hours reported by other railroads, but UP has reviewed its own procedures for reporting these data and believes it is following the instructions contained in Schedule 755.

3. KCPL's Variable Cost Calculations Contain Other Flaws.

Setting aside the question of how to account properly for UP's payments to MNA, if KCPL had performed its variable cost calculations in accordance with the Board's decision in *Major Issues* instead of making the improper adjustments discussed above, there still would be several differences in the parties' calculations.

First, KCPL's calculations incorporate the Board's 2005 determination of the railroad industry's cost of capital rather than the Association of American Railroads' proposed calculations for 2006. *See* KCPL Op. at I-19. UP used AAR's 2006 calculation because it is based on well-established methods, and no one has challenged that the mechanics of AAR's calculation.⁹

UP recognizes that the Board has recently proposed to revise its methodology for calculating the cost of capital. *See Methodology to be Employed in Determining the Railroad Industry's Cost of Capital*, STB Ex Parte No. 644 (STB served Aug. 14, 2007).¹⁰ However, even

⁹ The only reply filed in response to AAR's proposed calculations was a collateral attack on the current methodology. *See* Reply Comments of the Western Coal Traffic League, *Railroad Cost of Capital – 2006*, STB Ex Parte No. 558 (Sub-No. 10) (STB July 25, 2007). The Board had ordered parties to file comments that “focus on the various cost of capital components using the same methodology followed in the 2005 decision.” *See Railroad Cost of Capital – 2006*, STB Ex Parte No. 558 (Sub-No. 10), slip op. at 2 (STB served May 16, 2007).

¹⁰ In its opening evidence, KCPL “incorporated by reference” Western Coal Traffic League's criticisms of the Board's current cost-of-capital methodology and reserved the right to modify its submission if the Board adopts a new methodology. *See* KCPL Op. at I-19 to 20. UP is not responding to WCTL's criticisms in this filing because the Board made clear in its May 4 Order that the scope of this proceeding is limited. UP reserves the right to address those criticisms if the Board considers applying any new methodology to this proceeding. However, as (continued)

if the Board adopts the proposed methodology, a decision applying the new methodology in this case would be impermissibly retroactive if it would “increase [UP’s] liability for past conduct” *Landgraf v USI Film Prods* , 511 U S 244, 280 (1994), *see also Bowen v Georgetown Univ Hosp* , 488 U S 204, 219 (1988) (Scalia, J concurring) (application of a new rule would be impermissibly retroactive if it would “alter[] the *past* legal consequences of past actions”)

Application of a new cost-of-capital methodology that produces a lower cost than the current methodology would be especially arbitrary and capricious because UP established the challenged rates and terms, moved coal under those rates and terms, and collected revenue from those movements long before the Board revealed that it was considering a change to its current cost-of-capital methodology UP does not believe that it established unreasonable rates, but even if UP’s rates would have been found unreasonable under the current methodology, use of a new methodology would increase UP’s liability, and a new rule “increasing the amount of damages available under a preestablished cause of action” cannot be applied to “cases arising before the [rule’s] effective date.” *Id* at 283 The Board’s application of such rule to pending cases would impermissibly “impose on [defendants] found liable a new disability in respect to past events” *Id* (internal citation omitted) ¹¹

Second, in indexing 2006 URCS costs, KCPL and UP used different measures to reflect changes in fuel costs Consistent with the practice in prior coal rate cases, UP developed

discussed below, the Board may not apply any new cost-of-capital methodology in this proceeding if it would increase UP’s liability for establishing and collecting the challenged rates

¹¹ As discussed in UP’s opening evidence, the same type of retroactivity problem requires the Board to treat UP’s payments to MNA as a variable cost, because they would have been treated as a variable cost under the rules that applied before the Board’s decision in *Major Issues* See UP Op at I-4 (“[I]f the Board were to evaluate the challenged rates under the standards that applied when UP established the challenged rates, KCPL’s complaint would be dismissed”)

an index based on publicly available data regarding UP's system-average fuel costs. By contrast, KCPL mixed apples and oranges by using regional fuel cost data to index UP-specific 2006 URCS costs, despite the fact that UP supplies the fuel for the road units for this movement.

Third, in two instances, KCPL used data that were different than the stipulated numbers in the Joint Submission. UP identifies those minor differences in Section II.

C. KCPL'S UNREASONABLE PRACTICE CLAIM SHOULD BE DISMISSED.

In its opening evidence, KCPL claimed that UP engaged in an unreasonable practice by establishing a "volume cap" of 2.1 million tons when it established the challenged rates and asked the Board to "order UP to eliminate the cap, or at least raise it to 2.4 million tons." KCPI Op. IV-2. KCPL's claim has no merit. KCPI improperly seeks to burden UP with obligations above and beyond those imposed by the Interstate Commerce Act.

Under the challenged rates, UP committed for a three-year period to (i) deliver a specified minimum volume of coal, (ii) at pre-determined rates, (iii) pursuant to a special service commitment that included a liquidated damages provision. UP had no statutory obligation to make any of these special commitments. Rather, UP was obligated to (i) provide transportation on reasonable request, *see* 49 U.S.C. § 11101(a), (ii) not increase rates without providing 20-days' notice, *see id.* § 11101(c), and (iii) transport the traffic with reasonable dispatch, *see* 49 C.F.R. pt. 1035, App. B, § 2(a).

KCPI claims that UP acted unreasonably by refusing to extend the same special commitments to all of the coal that KCPI might want to ship to Montrose no matter how much it exceeded KCPI's past volume. Under KCPI's theory, if KCPL wanted 2.4 million tons of coal in one year and UP reasonably could deliver only 2.1 million tons, KCPL would be entitled to liquidated damages, even though UP never held itself out to deliver the additional tonnage under

service terms contained in Item 4140, even if KCPL's request for the additional deliveries was not reasonable, and even if KCPL would not be entitled to damages for the shortfall under the reasonable dispatch standard. KCPL's claim is a clear case of overreaching.

If KCPL wanted to ship more than 2.1 million tons of coal in any of the three years covered by the challenged rates, it was in the same position as any other shipper requesting common carrier service. As KCPL admits, UP never told KCPL that it would not ship more than 2.1 million tons of coal to Montrose. Instead, UP told KCPL that if it wants to ship more coal, it could request Option 1 rates. *See* KCPL Op. at I-27. Option 1 rates are basic unit-train common carrier rates. UP cannot have engaged in an unreasonable practice by treating KCPL like any other shipper that requests common carrier rates and service terms.¹²

Moreover, UP's decision to limit its service commitment to 2.1 million tons of coal was "reasonable" under a commonsense meaning of the term. As KCPL's own evidence shows, PRB coal shipments to Montrose did not exceed 2.1 million tons in any of the years before UP established the challenged rates. *See* KCPL Op. at IV-3, Table IV-1. The average over the preceding three-year period was 1.87 million tons, and the range was 1,626,542 tons to 2,034,397 tons. *See id.* In other words, UP actually committed to shipping more tonnage than KCPL had ever shipped before. Moreover, KCPL never shared its multi-year projections with UP when the parties were engaged in discussions about the volume provisions in Item 4140. Even now that KCPL has made the self-serving decision to reveal its current projections, the projections assume that KCPL ships only 8400 Btu coal, rather than the 8800 Btu coal that it

¹² In response to shipper demands for common carrier rates after other coal contracts expired, UP established rates that do not include a service commitment for Wisconsin Power & Light Company (*see* STB Docket No. 42051), Northern States Power Company Minnesota (*see* STB Docket No. 42059), and Arizona Electric Power Cooperative (*see* STB Docket No. 42058).

prefers to use and that generates the same amount of energy using 4 to 5 percent fewer tons See KCPL Op at IV-4 n 2

Finally, UP cannot be faulted for refusing to over-commit its limited capacity to KCPL In its response to KCPL's request for a higher volume commitment, UP made clear that it was unable to accommodate KCPL's request because of its capacity concerns¹³ KCPL argues that a volume cap was "without precedent in the history of UP coal service to Montrose" KCPL Op at I-26 However, the last time UP and KCPL entered into a contract for the transportation of PRB coal to Montrose was December 1995, ten years before UP established the challenged rates As the Board has recognized, "[R]ailroad conditions today are quite different from what they were even 10 years ago Traffic is up and capacity is tight" *N Am Freight Car Ass'n v BNSF Ry*, STB Docket No 42060 (Sub-No 1), slip op at 6 (STB served Jan 26, 2007) Open-ended contractual volume commitments may have been "a common practice in the past, [but] that does not mean that it is unlawful for carriers to [adopt a new approach] under today's conditions" *Id*

* * *

In recent proceedings, UP has described the challenges it faces in addressing the growing demand for transportation of Southern PRB coal in light of its capacity constraints¹⁴ UP understands KCPL's interest in obtaining an open-ended service commitment from UP, but UP made a reasonable decision in light of demand relative to its capacity and KCPL's historical

¹³ See UP Reply Electronic workpaper "UP_letter_to_KCPL.pdf"

¹⁴ See Opening Submission of Union Pacific Railroad Co at 7-15, *Major Issues in Rail Rate Cases*, STB Ex Parte No 657 (Sub-No 1) (STB May 1, 2006)

shipment levels. KCPL is not legally entitled to a greater service commitment than any other customer that requests transportation subject to the jurisdiction of the Board.

D. KCPL MISCHARACTERIZES UP'S RELATIONSHIP WITH MNA.

UP's opening evidence contained an alternative set of variable cost calculations that accounted properly for the variable costs of handling the issue traffic between Kansas City and Montrose on the MNA. Unlike KCPL's opening evidence, UP's effort to address the MNA portion of the issue movement did not involve excluding categories of costs that otherwise would be automatically included by the URCS Phase III program, substituting movement-specific data for system-average values used by the Phase III program, or making bogus "corrections" to system-average URCS. Instead, UP applied system-average URCS costs to the fullest extent possible without making any adjustments, and it applied well-established Board precedent to account for its payments to MNA, which are "not captured as costs in URCS." *Major Issues*, slip op. at 57. In other words, UP's effort to address its payments to MNA was an effort to address a cost that would not be included in cost calculations performed using the Phase III program.

UP's opening evidence also demonstrated that the challenged rates, which UP established prior to the Board's decision in *Major Issues*, would be found lawful if the Board were to evaluate them under the law as it existed prior to the Board's decision in *Major Issues*. See UP Op. at 1-3 to 4 & Ex. A. Accordingly, the Board's decision in *Major Issues*, if applied to this case, would not only disrupt UP's expectations when it established the challenged rates – as the Board acknowledged in *Major Issues*, its decision represented a "reversal of position from prior cases." slip op. at 60 – but also increase UP's liability for its past decision establishing the challenged rates. A Board decision to apply its new rule regarding third-party payments to this case would thus be impermissible for the same reasons the Board could not apply a new rule

regarding the cost of capital. See p 1-9, *supra* (discussing *Landgraf v USI Film Prods*, 511 U S 244 (1994) and *Bowen v Georgetown Univ Hosp*, 488 U S 204 (1988)).

UP will not repeat the arguments in favor of its proposed approach and against the Board's decision in *Major Issues*. However, UP will briefly address KCPL's claim that UP's payments to MNA are no different from revenue divisions associated with a joint rate for a through movement. See KCPL Op at I-20.

The proper treatment of UP's payment to MNA would not be a matter of serious dispute under the law as it existed before *Major Issues*. Under the law as it existed before *Major Issues*, a defendant's payments to a third party for handling issue traffic over a portion of the issue route were treated as variable costs if the defendant was "ultimately responsible" for delivering the traffic. *FMC Wyo Corp v Union Pac RR*, 4 S T B 669, 760 (2000). UP's opening evidence clearly demonstrated that UP is ultimately responsible to KCPL under the challenged tariff. See UP Op at I-6. It also demonstrated that UP's lease agreement with MNA gives UP the ability to fulfill its commitment to KCPL, and indeed that UP modified the lease to address concerns about its service commitments that were raised by KCPL. See *id* at I-6 to I-7.

UP's obligations to KCPL under the challenged tariff are plainly different from UP's obligations to shippers in situations involving joint rates and divisions. Under the challenged tariff, for movements involving joint rates, "UP [is] not responsible for delays attributable to [the] connecting carrier's inability to accept trains at interchange or delays on the connecting carrier's portion of the route." See Option 2, Part II D.¹⁵ Moreover, in the typical joint rate situation, UP does not have agreements with its connecting carriers that impose

¹⁵ UP included the challenged tariff as an electronic workpaper in its opening evidence. See UP Op electronic workpaper "KCPL_Tariff.pdf".

specific maintenance requirements on them, *compare* MNA Lease § 6 01, give UP the right to inspect their premises and order repairs, *compare id* § 6 02, prohibit them from discontinuing operations without regulatory authority, *compare id* § 3 02. require them to relinquish their premises to UP if they obtain regulatory authority to suspend operations, *compare id* § 3 03, or allow UP to obtain trackage rights over or enter their lines if they are unable to provide service, *compare id* , Second Supplemental Agreement § 1

KCPL argues that UP's payments to MNA should be treated as divisions of a joint rate because MNA is "an independent rail carrier" operating with "ICC approval " KCPL Op at I-21 However, MNA's status as an "independent rail carrier" is irrelevant under the law as it existed before *Major Issues* For example, in *Petition of Rio Grande Western Railroad*, the ICC treated Rio Grande's payments to UP as a cost to Rio Grande, even though UP was plainly an "independent rail carrier" operating with "ICC approval " See *Petition of Denver & R G W R R & Salt Lake, G & W Ry for Review of a Decision of the Pub Serv Comm'n of Utah Pursuant to 49 U S C 11501*, ICC Docket No 39060, slip op at 8-9 (ICC served Nov 14, 1985), *aff'd in relevant part sub nom Utah Power & Light Co v ICC*, 747 F 2d 721, 740-41 (D C Cir 1984) Similarly, in *FMC*, UP's payments to Conrail and the Belt Railway of Chicago were treated as variable costs, even though Conrail and the Belt Railway were independent rail carriers operating with agency approval See *FMC*, 4 S T B at 754, 760

Finally, KCPL states in its opening evidence that it treated UP's payments to MNA "as an offset to UP's revenues " KCPL Op at II-A-22 But KCPL's workpapers do not show any such offset Instead, KCPL calculated revenue-to-variable cost ratios by comparing the total revenues received by UP (before deducting its payment to MNA) with the variable costs for the movement from the Southern PRB to Montrose In fact, if KCPL actually meant to

reduce UP's revenues while keeping variable costs the same. UP's revenue-to-variable cost ratios would have been well below the 180-percent jurisdictional threshold ¹⁶

E. CONCLUSION

KCPL's opening evidence contains two alternative variable cost calculations, but neither complies with the Board's decision in *Major Issues*, which prohibits movement-specific adjustments to system-average URCS and the Phase III program

KCPL's opening evidence also fails to distinguish UP's payments to MNA from payments to third parties that the Board would have treated as variable costs under the law as it existed before *Major Issues*

The Board should calculate variable costs in this case by treating UP's payments to MNA as a variable cost and calculating the variable costs for the remaining portions of the issue movement as set forth in *Major Issues*. That is the proper approach as a matter of costing principles, and it avoids the impermissible retroactive application of the new rules that the Board adopted in *Major Issues*. However, if the Board treats the issue traffic as an interline movement with an interchange between UP and MNA in Kansas City, it should calculate variable costs using the nine operating characteristics the parties jointly submitted and the URCS Phase III model, without any of the adjustments proposed by KCPL

¹⁶ KCPL may have been trying to say that if the Board does not treat UP's payments to MNA as divisions, it should deduct the payments from UP's revenues *and* ignore the costs associated with MNA. However, the law as it existed before *Major Issues* recognized that UP's payments "are legitimate costs and not adjustments to revenues." See *FMC*, 4 S T B at 760-61

II. MARKET DOMINANCE

UP addressed the most significant flaws in KCPL's opening evidence in Part I. In this section, UP follows KCPL's outline of topics and identifies any remaining disagreements between the parties and any departures from the data contained in the parties' Joint Submission of URCS Phase III Operating Characteristics.

A. Summary of Variable Cost Analysis

UP disagrees with KCPL's variable cost calculations because they incorporate adjustments to system-average URCS and the Phase III program that are not permitted under the Board's decision in *Major Issues*.

B. Traffic and Operating Characteristics

KCPL states that it reserves the right to make a full evidentiary presentation on variable costs should the Board's decision in *Major Issues* subsequently be modified. See KCPL Op. at II-A-8. UP similarly reserves its rights. In light of the biased adjustments proposed by KCPL, it plainly would be inappropriate to accept those adjustments without permitting UP to propose its own set of adjustments.¹⁷

1. Details of URCS Phase III Inputs and Procedures

a) Railroad

KCPL's identification of the railroads is consistent with the Joint Submission

¹⁷ KCPL's opening evidence also purports to provide costing results for movements that occurred in the second quarter of 2007. See KCPL Op. Ex II-A-1. However, KCPL did not use the actual operating characteristics of the movements that occurred during that period. Instead, it based its cost calculations on the operating characteristics of trains that moved in the first quarter, and it assumed that all traffic moved in private cars. See *id.* n. 1. That is not an appropriate approach – indeed, it produces clearly erroneous results because certain shipments – namely, those from Black Thunder South mine – actually occurred in railroad-supplied equipment.

b) Loaded Miles

KCPL's identification of the number of loaded miles is consistent with the Joint Submission

c) Shipment Type

KCPL's identification of shipment types is consistent with the Joint Submission. However, as discussed in Part I, KCPL's exclusion of terminal switching costs is inconsistent with the designation of the UP portion of the movement as an "originated delivered" shipment and the MNA portion of the movement as a "received terminated" shipment and the URCS Phase III program's costing of those shipment types.

d) Cars per Train

KCPL's identification of the number of cars per train is consistent with the Joint Submission

e) Car Ownership

KCPL's identification of car ownership percentages is consistent with the Joint Submission

f) Tons per Car

KCPL's identification of the number of tons per car is consistent with the Joint Submission, except for shipments from Black Thunder mine in 4Q06 and Black Thunder South mine in 1Q07. KCPL's data are actually consistent with UP's initial calculations, but UP agreed to adopt KCPL's proposed figures for purposes of the Joint Submission to avoid disputes. UP believes that the data in KCPL's opening evidence are correct (and they slightly favor UP), but UP is willing to abide by the Joint Submission.

g) Car Type

KCPL's identification of the car type is consistent with the Joint Submission

h) Movement Type

KCPL's identification of the movement type is consistent with the Joint Submission

i) Commodity

KCPL's identification of the commodity is consistent with the Joint Submission

j) Tare Weight

UP disagrees with KCPL's use of "actual" tare weights. As discussed in Part I, KCPL use of "actual" tare weights is inconsistent with the Board's decision in *Major Issues*. According, UP has not reviewed the data's accuracy.

2. Exclusion of Phase III Costs

UP disagrees with KCPL's exclusion of terminal switching costs and private car payment costs. As discussed in Part I, KCPL's treatment of these costs is flatly inconsistent with the Board's decision in *Major Issues*.

a) Terminal Switching

KCPL acknowledges that terminal switching costs are "automatically included by the URCS Phase III program." KCPL Op. at II-A-20. Its decision to exclude those costs thus violates the Board's decision in *Major Issues* that the "only adjustments allowed to the URCS Phase III program would be those adopted in Ex Parte No. 431 (Sub-No. 2)." Slip op. at 60.

Moreover, as discussed in Part I, UP incurs terminal switching costs in loading the issue traffic, interchanging it in Kansas City, and delivering it to Montrose, and those costs are not fully accounted for by including all loop track miles when calculating the loaded miles input used to develop line-haul costs. See pp. 1-5 to 6, *supra*. UP also incurs costs for intermediate switching that are excluded entirely by the Phase III program. See *id*.

b) Private Car Payments

KCPL acknowledges that private-car payment costs are “automatically included by the URCS Phase III program.” KCPL Op at II-A-20. Its decision to exclude those costs thus violates the Board’s decision in *Major Issues* that the “only adjustments allowed to the URCS Phase III program would be those adopted in Ex Parte No. 431 (Sub-No. 2).” Slip op at 60.

Moreover, as discussed in Part I, an approach that precluded UP from recovering a system-average allocation of its costs for private car payments from all of its traffic would preclude UP from recovering its variable costs on a system-wide basis. See pp. 1-6 to 7, *supra*.

3. MNA Divisions

UP disagrees that MNA should be treated as a party to a joint rate that receives a division for moving the issue traffic between Kansas City and Montrose. As discussed in UP’s Opening Evidence and at pages I-13 to 15 above, UP’s payments to MNA would have been treated as variable costs under the law as it existed before *Major Issues*. As discussed in Part I, KCPL’s efforts to argue to the contrary ignore the law as it existed before *Major Issues*.

4. Indexing

As discussed in Part I, UP disagrees with KCPL’s use of regional fuel cost data rather than UP’s system-average costs to index URCS fuel expenses.

5. Cost of Capital

UP disagrees with KCPL’s use of the Board’s 2005 railroad industry cost of capital determination. As discussed in Part I, the Board should apply the 2006 railroad industry cost of capital to traffic that moved in 2006, and index that figure for traffic that moved in 2007.

6. Rates and Related R/VC Calculations

UP disagrees with KCPL’s revenue-to-variable cost (“r/vc”) calculations for the reasons described above. In addition, UP and KCPL used different revenue figures in their r/vc

calculations. The challenged tariff establishes the same basic rate for movements from each origin mine, but the tariff incorporates a fuel surcharge, which can change on a monthly basis. UP calculated a single, weighted-average revenue for all mines that originated traffic in each quarter. KCPI., on the other hand, developed separate, weighted-averages revenues for each mine, and thus it ended up with revenues that varied depending on which mines had shipped traffic during different months in each quarter.

UP believes that neither approach is entirely correct. If reparations were to be awarded in this case, they should be calculated by origin and by month, because costs vary by origin and the challenged rate varied on a monthly basis. In light of the parties' agreement on the operating characteristics of the issue traffic, the parties should be able to agree on those figures in short order, if it proves necessary.¹⁸

C. Alternative Variable Cost Calculations.

UP disagrees with KCPI.'s alternative variable cost calculations. As discussed in Part I, UP's 2005 and 2006 data regarding train switching hours is accurate and consistent with UP's R-1 data in the past. In addition, KCPL's attempt to adjust UP's system-average URCS costs by "correcting" these data is impermissible under *Major Issues*.

¹⁸ KCPI.'s Exhibit II-A-7 contains a reparation estimate that calculates rates by shipment, but a review of the data reveals instances in which KCPL claims that the rate was not the same for all shipments in a particular month. See, e.g., KCPI. Op Ex II-A-7, lines 2 & 16. KCPL does not address these outliers, which overstate both the r/vc ratios and the reparations estimate that KCPL calculated. As explained above, UP charged the same rate per ton for all KCPI. movements in each month.

Respectfully submitted,



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August 20, 2007

CERTIFICATE OF SERVICE

I, Michael L Rosenthal, certify that on this 20th day of August, 2007, I caused a copy of Union Pacific's Reply Evidence to be served by hand on Kelvin J Dowd of Slover & Loftus, 1224 Seventeenth Street, N W , Washington, D C 20036



Michael L Rosenthal

IV. WITNESS QUALIFICATIONS AND VERIFICATIONS

A. Benton V. Fisher

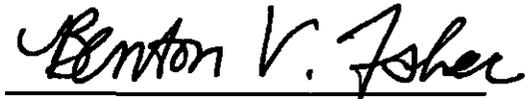
Benton V Fisher is a Senior Managing Director at FTI Consulting, Inc , an economic and financial consulting firm with offices located at 1101 K Street, N W , Suite B100, Washington, DC. 20005 Since 1991, Mr Fisher has been involved in various aspects of transportation consulting including economic studies involving costs and revenues, traffic and operating analyses, and work with performance measurement and financial reporting systems

Mr Fisher holds a Bachelor of Science in Engineering and Management Systems from Princeton University In 1991, he joined Klick, Kent & Allen, Inc , which was acquired by FTI Consulting, Inc in 1998 While with KK&A and FTI, Mr. Fisher has performed numerous analyses for and assisted in the preparation of expert testimony related to merger applications, rate reasonableness proceedings, contract disputes, and other regulatory costing issues before the Interstate Commerce Commission, Surface Transportation Board, Federal Energy Regulatory Commission, Postal Rate Commission, Federal Court, and State Utility Commissions

Mr Fisher is sponsoring evidence relating to Union Pacific's variable costs for the issue movement and Kansas City Power & Light Company's treatment of UP cycle-time data His evidence is incorporated in Sections I B and II B of the Narrative Mr. Fisher has signed a verification of the truth of the statements contained therein A copy of Mr Fisher's verification is attached hereto

I declare under penalty of perjury that I have read the Reply Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony.

Executed on August 20, 2007


Benton V Fisher

B. Robert L. Iserman

Robert L. Isermann is Manager - Car Accounting for Union Pacific Railroad Company. His office is located at 1400 Douglas Street, Omaha, Nebraska, 68179. Among his other responsibilities, Mr. Isermann is responsible for preparation of Schedule 755 of UP's Form R-1. Mr. Isermann has worked for Union Pacific, and before that, Missouri Pacific Railroad, for 37 years in various accounting positions.

Mr. Isermann is sponsoring evidence in Sections I B 2 of this Narrative relating to Union Pacific's reporting of train switching hours in UP's Form R-1. Mr. Isermann has signed a verification of the truth of the statements contained therein, a copy of which is attached hereto.

I declare under penalty of perjury that I have read the Reply Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony.

Executed on August 17, 2007


Robert L. Isermann

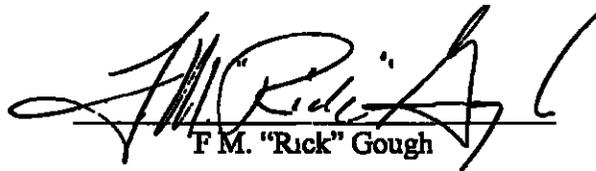
C. F.M. "Rick" Gough

F M "Rick" Gough is Senior Business Director - Energy for Union Pacific Railroad Company His office is located at 1400 Douglas Street, Omaha, Nebraska, 68179 Mr Gough has been employed by Union Pacific for more than 28 years and has served as Senior Business Director - Energy since June 1, 2000 In his current role, Mr Gough has primary responsibility for commercial aspects of relations with many of Union Pacific's customers that ship large quantities of coal from the Powder River Basin in Wyoming, including Kansas City Power & Light Company ("KCPL")

Mr Gough is sponsoring evidence in Section I C of this Narrative relating to communications between Union Pacific and KCPL regarding the volume commitment in the challenged tariff Mr. Gough has signed a verification of the truth of the statements contained therein A copy of Mr Gough's verification is attached hereto

I declare under penalty of perjury that I have read the Reply Evidence that I have sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct. Further, I certify that I am qualified and authorized to sponsor this testimony

Executed on August 17, 2007



F M. "Rick" Gough