PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42113

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
v.
BNSF RAILWAY COMPANY AND UNION PACIFIC RAILROAD COMPANY

FINAL BRIEF OF DEFENDANTS
BNSF RAILWAY COMPANY AND UNION PACIFIC RAILROAD COMPANY

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TABLE OF ABBREVIATIONS

AEO	Annual Energy Outlook
AEPCO	Arizona Electric Power Cooperative, Inc.
AEPCO Opening	Opening Evidence of Complainant Arizona Electric Power Cooperative, filed January 25, 2010
AEPCO Reb.	Rebuttal Evidence of Complainant Arizona Electric Power Cooperative, Inc., filed July 1, 2010
ANR	Arizona & Northern Railroad
Apache Station	Apache Generating Station
ATC	Average Total Cost
BNSF	BNSF Railway Company
CAPM	Capital Asset Pricing Model
EIA	U.S. Energy Information Administration
G&A	General and Administrative
GTW	Grand Trunk Western
KCS	Kansas City Southern
Joint Reply	Joint Reply Evidence and Argument of Defendants BNSF Railway Company and Union Pacific Railroad Company, filed May 7, 2010
MMM	Maximum Markup Methodology
MOW	Maintenance of Way
MRL	Montana Rail Link
MSDCF	Multi-Stage Discounted Cash Flow
PTC	Positive Train Control
PRB	Powder River Basin
R/VC	Revenue/Variable Cost
SAC	Stand-Alone Cost
SARR	Stand-Alone Railroad
SOO	Soo Line Railroad
STEO	Short Term Energy Outlook
SWRR	Southwestern Railroad
UP	Union Pacific Railroad Company
URCS	Uniform Rail Costing System

CASE NAMES

AEPCO August 2002	*Arizona Electric Power Cooperative Inc. v. Burlington Northern & Santa Fe Ry.*, 6 S.T.B. 322 (2002)
AEPCO May 2001	*Arizona Electric Power Cooperative Inc. v. Burlington Northern & Santa Fe Ry.*, 5 S.T.B. 531 (2001)
AEP Texas 2007	*AEP Texas North Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No. 1) (served Sept. 10, 2007)
AEP Texas 2009	*AEP Texas North Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No. 1) (served May 15, 2009)
Bottleneck I	*Central Power & Light Co. v. Southern Pacific Transp. Co.*, 1 S.T.B. 1059 (1996)
Bottleneck II	*Central Power & Light Co. v. Southern Pacific Transp. Co.*, 2 S.T.B. 235 (1997)
Burlington Northern	*Burlington Northern R.R. v. S.T.B.*, 75 F.3d 685 (D.C. Cir. 1996)
Duke Energy	*Duke Energy Corp. v. Norfolk Southern Ry.*, 7 S.T.B. 89 (2003)
FMC	*FMC Wyoming Corp. v. Union Pacific R.R.*, 4 S.T.B. 699 (2000)
KCPL	*Kansas City Power & Light Co. v. Union Pacific R.R.*, STB Docket No. 42095 (served May 19, 2008)
Major Issues	*Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (served Oct. 30, 2006)
Otter Tail	*Otter Tail Power Co. v. BNSF Ry.*, STB Docket No. 42071 (served Jan. 27, 2006)
PSCo/Xcel	*Public Service Co. of Colorado d/b/a Xcel Energy v. Burlington Northern & Santa Fe Ry. Co.*, 7 S.T.B. 589 (2004).
TMPA	*Texas Municipal Power Agency v. Burlington Northern & Santa Fe Ry.*, 7 S.T.B. 803 (2004)
US Magnesium	*US Magnesium, L.L.C. v. Union Pacific R.R.*, STB Docket No. 42114 (served Jan. 28, 2001)
West Texas	*West Texas Utililities Co. v. Burlington Northern R.R.*, 1 S.T.B. 638, 657 (1996)

FINAL BRIEF OF DEFENDANTS

This is the Final Brief of Defendants BNSF Railway Company ("BNSF") and Union Pacific Railroad Company ("UP"). For the reasons set out below and in defendants' reply evidence and argument, AEPCO's complaint should be dismissed.

I. INTRODUCTION

In its rebuttal evidence and argument, AEPCO acknowledges that the rates it pays do not cover the cost of facilities used to provide the issue traffic transportation. For the New Mexico issue traffic, which is the only issue traffic moving today, AEPCO admits that the real-world route "using Deming as the connection for the New Mexico movements would cause the SARR . . . to fail the *PPL Montana* cross-subsidy test on the Belen-Rincon segment." AEPCO Reb. at III-A-17. That should be the end of the inquiry. The SAC test is a test for cross-subsidy, but AEPCO is not being asked to subsidize any other traffic on defendants' rail networks because AEPCO does not even pay rates that are sufficient to cover the cost of the facilities it uses. The challenged rates do not exceed maximum reasonable rates under a straightforward application of the SAC test.

Unable to meet its burden under the SAC test applied by the Board, AEPCO invents a new transportation service through new interchange points with a completely different allocation of responsibility between defendants for providing the interline service, and then seeks to show that defendants' rates for the new service – which are non-existent because defendants do not provide that alternative service and therefore never established rates for it – are unreasonably high. AEPCO's SAC presentation is completely untethered from reality. It says nothing about the reasonableness of the rates at issue in this case. If defendants had chosen to provide the alternative transportation service assumed by AEPCO, which for New Mexico origins would require a far less efficient route that is almost 50% longer than the real-world route, the higher costs of that alternative service would have led to a higher rate and a higher jurisdictional threshold for the Board's consideration in a rate reasonableness challenge. But defendants do not provide the alternative transportation posited by AEPCO, nor have they been asked to do so by the shipper or ordered to do so by the Board. The governing statute gives railroads the prerogative to choose where they will interchange traffic, and the defendants here chose to provide the most efficient service over the most direct route available. The rates for that service are reasonable and the complaint should be dismissed.

In response to AEPCO's SAC presentation in its prior rate case against defendants, the Board made clear that "[a]ny SAC presentation must necessarily be grounded in, and bounded by, what is reasonable and appropriate to serve the purpose of the SAC test." *Arizona Electric Power Cooperative Inc. v. Burlington Northern & Santa Fe Ry.*, 6 S.T.B. 322, 327 (2002) ("*AEPCO August 2002*"). The Board dismissed AEPCO's prior rate case because AEPCO's misuse of trackage rights arrangements between the defendants resulted in a SAC presentation that failed to provide any meaningful information on the question at the heart of the SAC analysis, *i.e.*, whether the complaining shipper is being asked to pay for facilities from which it derives no benefit. AEPCO's current rate case should be dismissed for the same reason. AEPCO's manipulation of the interchange points between defendants results in a SAC presentation that fails to provide any meaningful information on the question whether defendants are charging rates that result in AEPCO cross-subsidizing portions of the defendants' networks from which AEPCO receives no benefit.

As in its prior case, AEPCO cannot show that its rates exceed a reasonable maximum rate without distorting the SAC analysis to the point where it no longer makes any sense. The implausible results of AEPCO's SAC analysis reflect the lengths to which AEPCO has gone to distort the rate reasonableness inquiry. By altering the interchange points for the issue traffic service and using a single SARR to evaluate the reasonableness of rates from diverse geographic origins, AEPCO presents results suggesting that the maximum SAC rates for movements that include some of the longest PRB movements on the defendants' rail networks should be below the defendants' variable costs for those movements. As with AEPCO's prior rate challenge, AEPCO's SAC presentation here makes no sense and its complaint should be dismissed.

This Final Brief summarizes the evidence and argument on AEPCO's manipulation of the interchange location between defendants, the central issue in this case, as well as the evidence and argument on other significant issues of SAC theory and methodology raised by the parties.

II. AEPCO MUST RESPECT THE INTERCHANGES AGREED TO BY BNSF AND UP.

The most important issue in this case is whether the complainant in a rate reasonableness case involving interline transportation can ignore the defendant railroads' allocation of responsibility between themselves for the issue traffic service by assuming alternative, hypothetical interchange points. As defendants explained in their reply evidence and argument, manipulation of the interchange points produces economically meaningless SAC results that say nothing about whether defendants are overcharging for transportation on the portions of their rail networks used to provide the issue traffic service. Further, defendants explained that AEPCO's manipulation of the interchange points conflicts with the statutory scheme governing rate reasonableness cases and with the rights and obligations of interline railroads to establish through routes and rates. AEPCO's arguments on rebuttal fail to address these fatal flaws, and AEPCO offers no valid basis for disregarding the real-world interchanges established by BNSF and UP.

A. Ignoring the Interchanges Agreed to by Defendants Produces a Meaningless SAC Analysis.

As defendants explained on reply, the SAC test is essentially a test for cross-subsidy. Joint Reply at I-23. The SAC test determines whether the issue traffic, along with traffic that shares the facilities used by the issue traffic, is paying for facilities that the traffic group does not use. To make this determination, the SAC test asks whether the issue traffic and the other traffic with which the issue traffic shares facilities are generating revenues in excess of the costs necessary to provide them with service. *Otter Tail Power Co. v. BNSF Ry.*, STB Docket No. 42071, slip op. at 24 (served Jan. 27, 2006) ("*Otter Tail*"). If not, then it is clear that the issue traffic is not being asked to pay for facilities from which it receives no benefit because it is not even paying rates sufficient to cover the full cost of the facilities it does use.

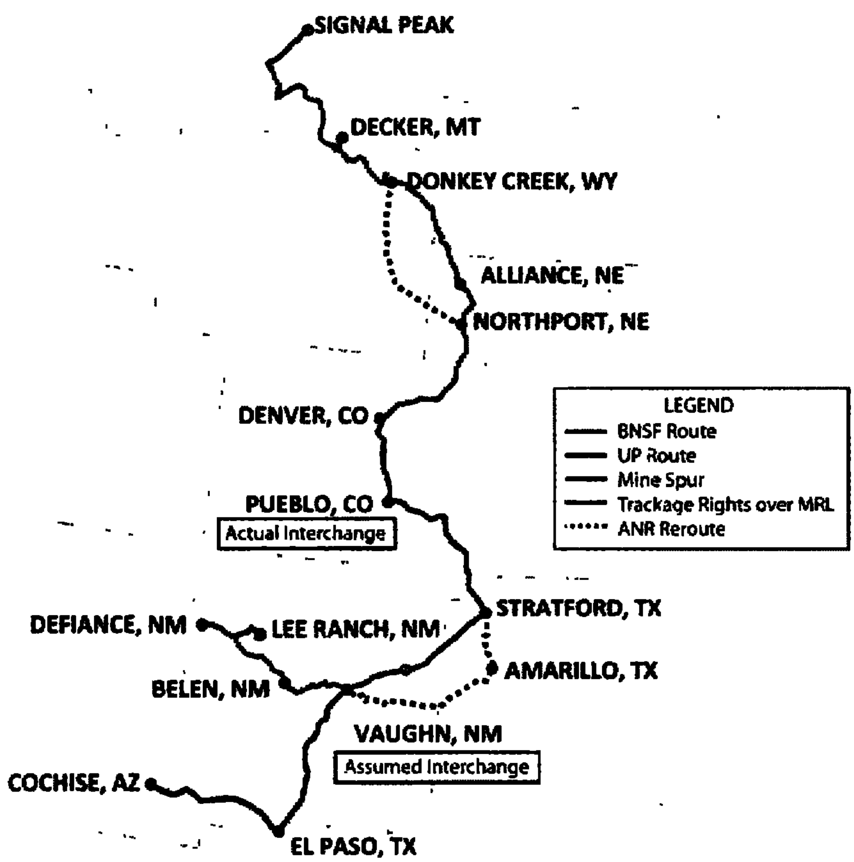
In a rate reasonableness case involving interline transportation, the cross-subsidy test only makes sense if it looks at costs and revenues on the portions of the defendants' networks used to provide the issue traffic service. This follows from the general SAC principle reiterated by the Board in *TMPA* that "the analysis of the reasonableness of a defendant carrier's rate should be based on the extent of the defendant carrier's participation in the movement." *Texas Municpal Power Agency v. Burlington Northern & Santa Fe Ry.*, 7 S.T.B. 803, 821 (2004); *see also Ass'n of Am. R.R. – Petition Regarding Methodology for Determining R.R. Revenue Adequacy*, STB Ex Parte No. 679, slip op. at 3 (served Oct. 24, 2008) (SAC is designed "to estimate the costs associated with providing service over a specified portion of a carrier's system (for the purpose of determining if a particular rate charged for service over that portion of the system results in a cross-subsidy of other parts of the carrier's system)."). In an interline movement involving service provided by two carriers, the defendants' participation in the movement is defined by the interchange point between them and the origin or destination point that each serves.

The complainant in a case involving an interline movement must respect the real-world interchange point selected by the defendants because that interchange point defines the traffic that is available to share the cost of facilities used by the issue traffic. As the Board explained in the prior AEPCO case, it would make no sense to include in the SAC analysis "another carrier's traffic and revenue that do not or could not reasonably be expected to pay for the defendant carrier's costs." *AEPCO August 2002*, 6 S.T.B. at 328. In an interline case, the traffic available to offset the costs of each portion of the movement is the traffic available to each defendant over that portion of the movement for which it is responsible. Accordingly, in this case, BNSF traffic is not available to UP to offset UP's costs over the portion of the movement for which UP is responsible, just as UP traffic is unavailable to BNSF to offset BNSF's costs for that portion of the service that BNSF provides. The Board also acknowledged this principle in the earlier AEPCO decision: "[F]or each segment of a route used to test the respective joint rates, only the traffic and revenues of the carrier whose portion of the route is being replicated should be included in the SARR's traffic group." *Id.* at 329.

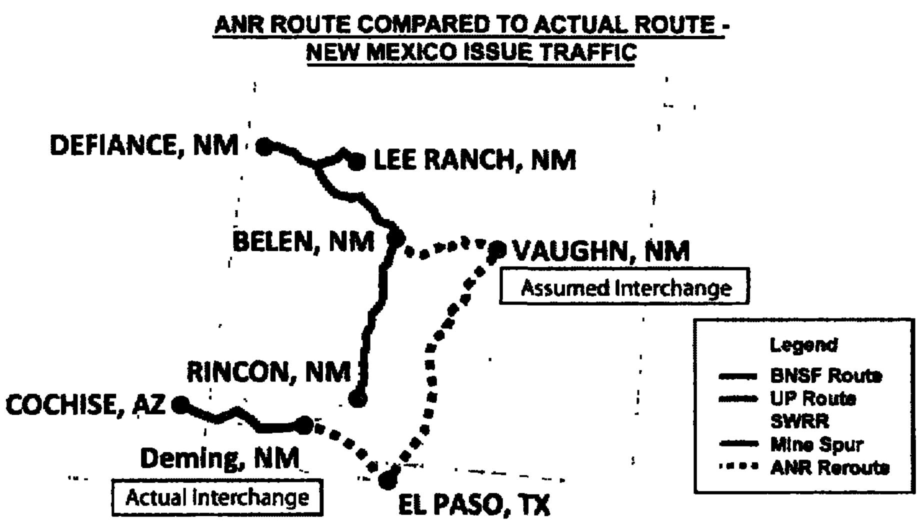
AEPCO's SAC presentation is therefore meaningless because it assumes traffic sharing arrangements that do not exist and could not exist consistent with the defendants' allocation of responsibility for their respective portions of the interline movement. As defendants described in their reply evidence, AEPCO assumed that the real-world interchange between defendants for the PRB traffic would be moved from Pueblo, Colorado, to Vaughn, New Mexico. (A map of the PRB movement from defendants' reply evidence is reproduced below.) AEPCO then used that modification as an excuse to include revenues from BNSF's transcontinental traffic from

Amarillo to Vaughn in the SAC analysis to offset the costs to provide the PRB issue traffic transportation service. Joint Reply at I-26. Those BNSF revenues, however, are irrelevant to a proper cross-subsidy analysis since UP, not BNSF, is responsible for moving the issue traffic between Pueblo and Vaughn. UP has no claim to the BNSF revenues in the real world; they are not available to offset UP's cost of providing service south of Pueblo; and they are not relevant to a proper cross-subsidy analysis.

ANR ROUTE COMPARED TO ACTUAL ROUTE - PRB ISSUE TRAFFIC



Similarly, with respect to the New Mexico traffic, AEPCO assumed that the real-world interchange between BNSF and UP would be moved from Deming, New Mexico, to Vaughn, New Mexico, so that AEPCO's SARR could use revenues from traffic on UP's Tucumcari line to offset the costs to serve the issue traffic. (A map of the New Mexico movement from defendants' reply evidence is reproduced below.) But since BNSF is responsible for the portion of the movement to Deming, not UP, UP's Tucumcari traffic is not available to offset BNSF's costs, and it makes no sense to include those revenues in a cross-subsidy analysis.



Defendants showed schematically how the SAC results could be distorted by grabbing revenue from another railroad, including an interline partner, to offset the costs of facilities that are used by the issue traffic. Joint Reply at I-28 to I-29. On rebuttal, AEPCO did not even attempt to rebut defendants' showing that such a manipulation of traffic grouping could make reasonable rates appear to be unreasonable, which is precisely what AEPCO is attempting to do here.

B. Ignoring the Real-World Interchanges Established by Defendants Violates the Statutory Scheme.

AEPCO's assumption of an alternative interchange arrangement between BNSF and UP is also inconsistent with the existing statutory scheme. The location of the interchange between the interline carriers is a central feature of a joint through rate. Indeed, the statute expressly recognizes that rates for interline transportation are "applicable to" the through routes the carriers have "establish[ed]," which necessarily entails the specification of an interchange point. 49 U.S.C. § 10703. The economic logic of this statutory provision is that the level of the through rate charged by two interline carriers is a function of the interchange point. In this case, BNSF and UP explained that they would have charged different through rates if they had chosen to provide service over different through routes with different interchange points. In effect, by shifting the interchanges, AEPCO is attempting to challenge non-existent rates that would, if they existed, be different from the rates actually charged by defendants. But under 49 U.S.C. § 10704(a)(1), the Board's authority to regulate rates extends only to "a rate charged or collected" by the defendants. The Board has no authority to address the reasonableness of a hypothetical rate that defendants have never established over interchanges that the defendants have not chosen to use.

The defendants' choice of the interchange point has consequences under the governing statute that cannot be ignored. As demonstrated by AEPCO's SAC presentation, transportation over alternative interchanges would produce costs that can vary dramatically. For the New Mexico movement, AEPCO's alternative transportation service involves a movement that is almost 50% longer than the real-world movement. The higher costs of the alternative movement would result in a higher jurisdictional threshold for the alternative service. Joint Reply at II.A-3, A-4. The Board would not have jurisdiction to review the reasonableness of a rate for the alternative service that was less than 180% of the variable costs of the alternative service. AEPCO cannot avoid these legal consequences of the defendants' choice of interchange by merely assuming that defendants chose to provide the alternative service. As defendants explained in their reply evidence, it would be arbitrary under the existing statutory scheme for the Board to establish a rate prescription based on an assumption that BNSF and UP provide higher cost alternative service while basing the calculation of the jurisdictional threshold on the lower cost service that defendants actually chose to provide because it was more cost effective. Joint Reply at I-30.

Moreover, AEPCO's disregard for the interchanges that defendants established violates the statutory rights given to interline carriers to determine the through route to be used for joint transportation and the interchange to be used. 49 U.S.C. § 10703. The Board's *Bottleneck* decisions affirm the statutory right of rail carriers to establish the interchange in the first instance. *Central Power & Light Co. v. Southern Pacific Transp. Co.*, 1 S.T.B. 1059 (1996) ("*Bottleneck I*"); *Central Power & Light Co. v. Southern Pacific Transp. Co.*, 2 S.T.B. 235 (1997) ("*Bottleneck II*"). *See* Joint Reply at I-20 to I-23. *Bottleneck II* expressly holds that "the determination of an interchange point for [a] through movement is, in the first instance 'a matter of mutual consultation and agreement'" between the railroads. *Bottleneck II*, 2 S.T.B. at 243 (citations omitted). The Board intervenes only if the railroads are unable to agree. *Id.* at 243-44.

The *Bottleneck* cases are directly relevant here. In those cases, shippers claimed that they were entitled to dictate the through routes for interline movements and to force the defendant carriers to establish interchange points that were different from those they had selected. The Board rejected the shippers' arguments: "[I]f a shipper wants a route other than the one currently provided by the bottleneck carrier, it must invoke [the] 'competitive access' regulations and demonstrate that the bottleneck carrier's refusal to establish such a route would foreclose more efficient service." *Bottleneck II*, 2 S.T.B. at 238. Permitting a shipper to obtain alternative routing or interchanges without making this showing "would defeat the carrier's initial discretion to choose its routes and protect its long hauls." *Id.* at 237-38.

As described in defendants' reply evidence, AEPCO could not make the showing that would be necessary to force defendants to provide the alternative service assumed by AEPCO because the alternative service would be so much less efficient than the actual service that AEPCO receives. AEPCO should not be permitted to circumvent the competitive access rules and the railroads' prerogative to designate interchanges by merely hypothesizing a SARR that ignores the real-world interchanges. A rate prescribed on the basis of alternative interchanges would effectively be a declaration that the railroads should be using the alternatives in the real world. Moreover, that determination would be made without the required showing that the real-world interchange is inefficient.

C. AEPCO Has Identified No Valid Basis for Disregarding the Interchanges Established by BNSF and UP.

AEPCO presents several arguments on rebuttal in an attempt to justify its use of alternative interchanges, but none withstands scrutiny.

AEPCO relies primarily on the false claim that in the prior AEPCO SAC case, the "Board has already decided the issue and rejected BNSF/UP's position." AEPCO Reb. at III-A-18. The only issue that was actually decided in the prior case was that AEPCO failed to present viable SAC evidence by manipulating trackage rights arrangements between the two defendants. In the proceedings leading up to that ultimate decision, the Board indicated that the use of an alternative interchange in AEPCO's SAC presentation "would seem to be permissible," *AEPCO August 2002*, 6 S.T.B at 327, but that tentative statement at an early stage of the proceeding hardly constitutes a definitive ruling on the issue. Because the Board dismissed AEPCO's SAC evidence on other grounds, the Board never had the opportunity or reason to address the validity of AEPCO's assumed modification of the interchange point or to address any of the evidence or argument that defendants submitted on that issue.[1]

AEPCO also claims that since the Board allows a complainant to reroute issue traffic in the SAC analysis, AEPCO should be entitled to reroute the issue traffic over alternative interchange points. AEPCO Reb. at III-A-19 to A-21. But the issue here is not about rerouting traffic. AEPCO is free to reroute the issue traffic between the origin or the destination and the interchange point designated by the defendants. Rather, the issue here involves the allocation of responsibility between interline carriers for portions of the interline movement, as reflected in the defendants' designation of an interchange location. The ability to reroute traffic does not give the complainant in a SAC case the right to assume traffic grouping and cost sharing arrangements that do not and would not exist. The cost sharing arrangements posited by AEPCO are impermissible not because they occur through a rerouting of the issue traffic but because they are incompatible with the allocation of responsibility between defendants for the through movement as reflected in defendants' choice of a real-world interchange point.

AEPCO's primary substantive argument in defense of its alternative interchange assumption is that the SARR "stands in the shoes" of the defendants and thereby "acquires the defendants' prerogative to select a different point of connection for its segments." AEPCO Reb.

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[1] AEPCO similarly tries to rewrite history by claiming that the Board previously held that AEPCO was entitled to combine the New Mexico issue traffic and the PRB issue traffic into a single SARR. In fact, the Board stated that it was impermissible to combine separate challenges to rates into a single challenge. The Board instructed AEPCO that "AEPCO may not include any traffic or revenues . . . that could not have been treated in the same manner had AEPCO filed a separate complaint for that set of rates." *AEPCO August 2002*, 6 S.T.B. at 329-30. As defendants pointed out in their reply evidence, AEPCO would have had no basis for including any BNSF transcontinental traffic through New Mexico and Texas in an analysis of the PRB rates, since that BNSF traffic has no connection at all to the PRB movement. Joint Reply at I-4 to I-5.

at III-A-21 to A-22. AEPCO misconstrues the SAC principle, articulated in *West Texas Utilities Co. v. Burlington Northern R.R.*, 1 S.T.B. 638, 657 (1996) ("*West Texas*"), that the SARR "step[s] into the shoes of [the incumbent] under the existing transportation contracts." Under this principle, the SARR replaces the incumbent with respect to the transportation service provided by the incumbent and thereby inherits the traffic arrangements that the incumbent already made. But the SARR is not entitled to renegotiate the arrangements that the incumbent made, for example to negotiate different rates or interchanges with the incumbent's shippers. Rather, the SARR simply steps into the incumbent's shoes with respect to the incumbent's existing arrangements. Thus, in this case, the SARR steps into the shoes of the defendants with respect to the interchange locations that the defendants have already established. The SARR cannot assume a different interchange arrangement between the incumbents.

AEPCO appears to believe that when the SARR "stands in the shoes" of the defendants, it acquires the right to ignore the separate identities of the two carriers providing the through service. But when the SARR "stands in the shoes" of the incumbents in an interline movement, it does so in the incumbents' individual capacities. In effect, the SARR steps into two pairs of shoes – one for each carrier in the movement. There is no valid basis for ignoring the corporate boundaries of the two railroads providing the interline service. While BNSF and UP are joint providers of service to AEPCO, they have defined the boundaries of that portion of service that each provides, and they remain separate corporate entities. It makes no sense to use the revenues generated by BNSF to offset the costs of UP for the portion of the movement for which UP has responsibility and vice versa. Moreover, ignoring the independent existence of the corporate entities providing the transportation service would be at odds with the statutory scheme that recognizes that an interline movement is provided by independent entities that have the right to establish the boundaries of their responsibility for the transportation by designating the interchange location.

AEPCO suggests that respecting the independent existence of the interline carriers imposes a heightened burden on complainants challenging the reasonableness of an interline rate. AEPCO Reb. at I-13. This argument has no validity. Respecting the interchange does not change the substance of the SAC test. Respecting the interchange simply recognizes the plain fact that an interline movement is handled by more than one carrier with defined areas of responsibility between the carriers.

AEPCO also misses the point when it complains that the SARR should not be required to recreate the Belen to Rincon segment "that may have made sense over a hundred years ago . . . but which currently has enough traffic to warrant only its retention, but not its recreation." AEPCO Reb. at III-A-24. The issue traffic uses the Belen-Rincon line because it is the most efficient way to move traffic from the New Mexico mines to AEPCO's Apache Station. For that reason, defendants chose in the real world to allocate responsibility to BNSF for the portion of the transportation from the New Mexico mines to Deming. If AEPCO believed that defendants should have allocated responsibility for the through movement differently by establishing an interchange at Vaughn, thereby requiring a much longer movement, AEPCO should have pursued such a claim under the statute (49 U.S.C. § 10705) and regulations that pertain to such allegations.[2] But unless AEPCO could show that defendants should be providing the alternative transportation service through Vaughn (which AEPCO obviously could not do because of the

[2] If AEPCO were to prevail in such a case, it could then bring a rate reasonableness challenge to a rate established by defendants for such alternative service. However, in that rate case, the Board's jurisdiction would be defined by the much higher cost service that the defendants would be providing. AEPCO cannot have it both ways and assume that defendants provide the higher cost service but also assume that the Board's jurisdiction is defined by the lower cost service that defendants actually provide.

route's inefficiency), AEPCO should not be allowed to base its SAC evidence on such an alternative route.

In *Otter Tail*, the Board rejected the complainant's argument that "the internal cross-subsidy analysis deprives shippers in rural, light-density areas of relief under the SAC constraint." *Otter Tail*, slip op. at 25. Such shippers, the Board explained, "may well have to bear a greater portion of the costs of the infrastructure required for a lightly used line." *Id.* The Board made it clear that it would turn the SAC test on its head to allow such shippers to look to other traffic to subsidize the facilities used by the issue traffic. As the Board explained:

> A test designed to root out costs associated with cross-subsidization would be transformed into one where captive shippers seek out cross-subsidies to pay for the facilities needed to serve them. Indeed, were that allowed, captive shippers located on light-density lines almost anywhere on BNSF's 30,000 mile rail network could seek to exploit the traffic densities in the PRB to subsidize its traffic, and the SAC test would be corrupted beyond repair.

Id. Here, AEPCO has gone even farther to avoid a SAC test that reflects the issue traffic's use of the Belen-Rincon line. AEPCO not only sought to "exploit the traffic densities" on lines not used to provide the issue traffic service to subsidize its traffic, but it sought to subsidize transportation that is provided by BNSF with revenues from UP traffic on the Tucumcari line that does not even share facilities with the issue traffic. As the Board explained in *Otter Tail*, "[i]t cannot follow that the Board should grant relief under the SAC constraint where the challenged rate does not provide a reasonable return on the facilities needed to serve that captive shipper, let alone cross-subsidize other parts of the defendant's rail network." *Otter Tail*, slip op. at 25.

Finally, AEPCO argues that the SARR can ignore the interchanges established by defendants in a challenge to an interline rate because "[r]eal-world divisions simply do not enter into the determination of whether a joint-rate . . . is reasonable." AEPCO Reb. at III-A-25. This argument is a red herring. The rate divisions that BNSF and UP negotiated for the through movement are totally irrelevant for purposes of assessing AEPCO's SAC evidence. Defendants have never argued that the Board must assess the reasonableness of a challenged interline rate by separately analyzing the reasonableness of each carrier's revenue division. The reasonableness of the challenged rates must be assessed on a through basis. The question here is whether AEPCO can ignore the defendants' allocation of responsibility between them for the through movement in determining whether the through rates exceed the costs of the through service. That question has nothing to do with the revenue divisions that were established by the two carriers.

In short, this is a case where the rates for the transportation service that defendants actually provide do not cover the stand-alone costs of that service. AEPCO is not being asked to cross-subsidize facilities that it does not use because AEPCO is not even covering the cost of the facilities it does use. The rates are not unreasonable and the complaint should be dismissed.

III. THE BOARD SHOULD NOT PRESCRIBE MAXIMUM RATES FOR FUTURE MOVEMENTS OF COAL FROM ORIGINS IN MONTANA AND WYOMING TO APACHE STATION.

If the Board does not dismiss the complaint, it still should not prescribe maximum rates for future movements from origins in Montana and Wyoming. The Board has authority to prescribe maximum rates for future movements only if it concludes "that a rate charged or collected by a rail carrier . . . does or will violate this part." 49 U.S.C. § 10704(a)(1). {

} However, Congress established a balance that reflects not only AEPCO's interests, but also the importance of market-based rates, shipper-carrier negotiations, and the ratemaking discretion of railroads. AEPCO asserts that "there is no particular burden on [defendants] in maintaining [prescribed] rates. *Id.* at III-A-42. However, defendants would face a significant burden in losing their ratemaking discretion until 2019.[3]

With regard to Signal Peak coal, {

} Thus, contrary to AEPCO's claim (*id.* at I-18), the present situation is nothing like the earlier AEPCO case, where AEPCO claimed an "emergency" need for common carrier rates, and the Board had "no basis for finding that AEPCO will not use the rates it seeks in the foreseeable future." *Arizona Electric Power Cooperative Inc. v. Burlington Northern & Santa Fe Ry.*, 5 S.T.B. 531, 532 (2001) ("*AEPCO May 2001*"). Rather, this case is similar to *Burlington Northern Railroad v. S.T.B.*, where the D.C. Circuit held that the I.C.C. did not have the "statutory authority to impose upon a rail carrier a current obligation to file a tariff specifying a

[3] {

}

rate for traffic . . . that would not be ready to move under the rate until months or years down the road." *Burlington Northern R.R. v. S.T.B.*, 75 F.3d 685, 692 (D.C. Cir. 1996).

Ultimately, the Board need not deny relief on statutory grounds because it should decline to prescribe maximum future rates for movements of Wyoming and Montana coal as a matter of discretion. *See AEP Texas North Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No. 1) slip op. at 18 (served May 15, 2009) ("*AEP Texas 2009*"). {

} The Board should deny prescriptive relief to give teeth to its warning that it does "not intend to permit any party to manipulate our processes." *AEPCO May 2001*, 5 S.T.B. at 533. {

} so the Board should decline AEPCO's invitation to constrain defendants' ratemaking discretion in furtherance of the policy "to minimize the need for Federal regulatory control over the rail transportation system." 49 U.S.C. § 10101(2).

IV. THE URCS VARIABLE COSTS OF THE NEW MEXICO ISSUE TRAFFIC MUST REFLECT THE PARTICIPATION OF SWRR IN THE ROUTE.

There is no dispute that SWRR participates in the handling of the New Mexico issue traffic. BNSF originates the traffic and interchanges it with SWRR at Rincon, New Mexico. SWRR moves the traffic to a further interchange with UP at Deming, New Mexico, and UP completes the movement by delivering the coal to Apache Station. BNSF pays SWRR a handling fee. In the recent *KCPL* decision, the Board established that the URCS costs of such a movement should reflect the short-line railroad's variable costs over the portion of the movement provided by the short-line railroad and the costs of an interchange when the short-line railroad receives or delivers the traffic. In that case, the Board expressly rejected the complainant's argument that the existence of the short-line railroad should be ignored and the URCS costs of the defendant should be used as if there were no interchange with another railroad. *Kansas City Power & Light Co. v. Union Pacific R.R.*, STB Docket No. 42095, slip op. at 7 n.12 (served May 19, 2008) ("*KCPL*").

AEPCO nevertheless urges the Board to ignore SWRR's existence here and to assume, contrary to undisputed facts, that BNSF handles the movement continuously from the New Mexico mines to the interchange with UP at Deming. AEPCO seeks to distinguish *KCPL* on grounds that the "situation and impact in AEPCO's case are far different." AEPCO Reb. at II-10. Specifically, AEPCO argues that the short line in *KCPL* provided a larger portion of the total transportation service than SWRR. But the Board's decision in *KCPL* was not based on the relative portion of the transportation service provided by the short line. The Board never suggested that the short-line railroad's participation would be recognized only if it amounted to some minimum specified portion of the through movement. AEPCO suggests that perhaps the Board should ignore the existence of short-line railroads when their participation is "nominal or minimal." *Id.* But the Board never suggested such a vague standard and, in any event, the SWRR provides over 10% of the line-haul movement in this case, making its participation far more than "nominal or minimal."

AEPCO's basic substantive argument for ignoring SWRR's existence is that URCS does not correctly account for the costs associated with SWRR's handling of the New Mexico issue traffic. AEPCO argues that the Board should ignore SWRR's participation in the movement because the interchange between BNSF and SWRR is just a type of "run-through" arrangement and "the URCS Phase III program does not distinguish between run-through and more costly forms of interchange." AEPCO Reb. at II-16. AEPCO does not even try to hide the fact that its complaint is with the way URCS treats different types of interchange arrangements, specifically that URCS applies the same unit costs to relatively simple run-through arrangements, such as the one at issue here, as to more elaborate interchanges. There is no dispute that an interchange occurs between BNSF and SWRR. AEPCO just believes that URCS assigns too much cost to that interchange. But that is a complaint about the structure of URCS that has no place here. In *Major Issues*, the Board ordered the parties in rate reasonableness cases to use unadjusted system-average URCS to determine the jurisdictional threshold and to address any proposals for improving or better tailoring URCS in separate rulemakings. *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 60-61 (served Oct. 30, 2006) ("*Major Issues*").

AEPCO also argues that it is unfair to AEPCO to base the jurisdictional threshold on URCS variable costs associated with SWRR's participation in the movement when those costs are higher than the amount of the fee paid by BNSF to SWRR. AEPCO Reb. at II-13 to II-15. But the Board made it clear in *KCPL* that the amount of the fee paid to the short-line railroad for handling the movement is not relevant in determining the jurisdictional threshold. What is important is the cost of the movement, determined using URCS, as carried out with the participation of the short-line railroad. The commercial considerations that went into setting the fee paid to the short line are irrelevant because the jurisdictional threshold is based on the costs of the railroads to provide the service.

In addition, on rebuttal, AEPCO employed a newly constructed 2009 URCS for calculating variable costs for jurisdictional threshold purposes as well as for ATC and MMM calculations. It is inappropriate to submit new URCS calculations on rebuttal since defendants do not have an opportunity to verify the accuracy of those calculations. Indeed, AEPCO committed at least one substantial error in its rebuttal URCS calculations by omitting equipment depreciation costs. This error alone renders AEPCO's rebuttal URCS calculations useless.

V. TRAFFIC AND REVENUES

A. Exclusion of UP Traffic from Denver to Pueblo

In their reply, defendants explained that AEPCO improperly included revenue from UP traffic on the portion of its SARR that replaced BNSF between Denver and Pueblo. Joint Reply at III.A-15. AEPCO acknowledges on rebuttal that its approach is contrary to precedent, which would allow the SARR to have the benefit of any BNSF cost-savings from operating the Denver-Pueblo segment as a joint facility, but not the benefit of UP revenue. AEPCO Reb. at III-A-40. However, AEPCO claims that it is entitled to UP revenue because the cost-sharing arrangement is too difficult to model. *Id.* at III-A-41. AEPCO plainly recognized that its approach is invalid. When replicating BNSF operations over the PRB Joint Line, AEPCO properly selected only BNSF traffic and constructed only the facilities necessary to handle that traffic – it did not replicate the entire Joint Line and claim revenues from UP's operations in the PRB. AEPCO should have used the same approach on the Denver-Pueblo segment. Joint Reply at III.A-15. AEPCO's approach does not significantly impact this case because of the limited amount of revenue at issue on the Denver-Pueblo segment. However, the Board should firmly reject AEPCO's approach so that other shippers do not mistakenly follow the same path in subsequent cases.

B. MRL Traffic

AEPCO asserts that it should be able to include in its traffic group millions of tons of BNSF non-coal traffic that travels via trackage rights over MRL's rail line (not constructed by AEPCO) between Laurel, Montana, and Jones Junction, Montana, and never touches any of the

SARR's facilities simply because BNSF uses the MRL facilities in the real world. AEPCO Reb. at III-A-27 to A-31. AEPCO ignores altogether the principle articulated by the Board that "[i]nclusion of other traffic [in the SAC analysis] is appropriate where that traffic currently shares in the use of the facilities and should therefore contribute to the cost of those facilities." *Duke Energy Corp. v. CSX Transp., Inc.*, 7 S.T.B. 402, 419 (2004)("*Duke Energy*"). This MRL traffic does not share in the use of the ANR facilities, and therefore the revenues from the MRL traffic should not contribute to the cost of the ANR facilities. Joint Reply at III.A-9 to A-10; III.A-19 to A-20.

C. 2009 Base Year Volumes

Non-Issue Coal Traffic: To develop 2009 base year volumes for non-issue coal traffic, AEPCO "indexed down" the 2Q08-4Q08 actual volumes for coal in the traffic group selected by AEPCO using the April 2009 EIA update to its Annual Energy Outlook. AEPCO Opening at III-A-16; A-18. AEPCO's use of a forecast prepared in April 2009 did not adequately reflect the reduction in coal traffic volumes due to the recession; therefore, defendants used actual coal traffic data from 2009 to "index[] down" 2008 volumes to 2009 levels. On rebuttal, AEPCO's primary criticism of defendants' methodology is that defendants failed to include 2009 coal tons (a) from new origin regions that BNSF did not originate coal from in 2008 or (b) to new destinations that BNSF did not transport coal to in 2008. AEPCO Reb. at III-A-51 to A-53. AEPCO's argument is misplaced. Defendants did not try to create a new traffic group using 2009 data, and they would not have been permitted to do so under long-standing SAC precedent. Defendants simply produced a more accurate index, using actual 2009 data, to adjust AEPCO's chosen traffic to reflect the downturn in the economy.

Non-Coal Traffic: Similarly, to develop 2009 base year volumes for non-coal traffic, AEPCO "indexed down" the 2Q08-4Q08 actual non-coal volumes from the traffic selected for inclusion in the SARR using a methodology that relied on BNSF and UP system-wide data, AEPCO Opening at III-A-16, A-18, while defendants developed a superior index methodology that used actual 2009 non-coal data and focused on volume changes in the traffic lanes actually selected by AEPCO. Joint Reply at III.A-34 to A-37; A-40 to A-43. Again, AEPCO's criticism of defendants' approach is misplaced because it is based on the misperception that defendants used the 2009 data to select a non-coal traffic group rather than to develop a lane-specific method of "indexing down" the volumes of the 2008 non-coal traffic selected by AEPCO to 2009 levels.[4] Based on that misperception AEPCO erroneously claims that defendants developed a different 2009 non-coal traffic group for BNSF traffic than AEPCO because defendants did not include all the train symbols (and hence all the non-coal trains) selected by AEPCO. AEPCO Reb. at III-A-69 to A-72. In fact, while defendants used a selective group of the train symbols associated with the trains in AEPCO's traffic group to develop the adjustments used to "index down" 2008 non-coal volumes to 2009 levels, defendants applied the adjustment index to all BNSF non-coal trains in AEPCO's traffic group.

AEPCO falsely claims that defendants' non-coal adjustments are invalid because they result in larger volume reductions by business unit than the BNSF system-wide reduction volume reductions per business unit. AEPCO's Rebuttal Table III-A-5 shows that between 2008 and 2009 defendants' adjustment reduced Consumer traffic by 16.2%. However, on BNSF's system

[4] AEPCO complains that defendants failed to provide the 4Q09 waybill data that they relied on to develop 2009 base year volumes. AEPCO Reb. at III-A-66 n.41. Defendants intended to produce that data with their reply evidence and only learned that they had inadvertently failed to do so when AEPCO submitted its rebuttal evidence. Notably, AEPCO failed to include a request for such 4Q09 waybill data in their workpaper requests relating to other portions of defendants' reply evidence.

there was an 18.8% reduction in such traffic. AEPCO Reb. at III-A-72 to A-73. In any event, given that AEPCO only selected non-coal traffic on certain BNSF routes, it is not surprising that the volume reductions on those specific BNSF routes differed from the overall reductions on the entire BNSF system between 2008 and 2009.

Finally, AEPCO complains that that defendants' 2009 base year volume adjustments do not take account of better than expected volumes transported in 2010. AEPCO Reb. at III-A-73 to A-74. But the development of 2009 base year volumes and the projection of volumes in 2010 and beyond are two separate exercises – AEPCO, like defendants, uses a different methodology to develop 2009 base year volumes than it uses to project volumes in 2010 through 2018. Defendants disagreed with AEPCO's methodology for developing 2009 base year volumes but accepted AEPCO's use of the 2010 BNSF forecast to project non-coal volumes in 2010 and beyond.

D. Fuel Surcharge Revenues

AEPCO's rebuttal evidence continues to overstate SARR fuel surcharge revenues from 2012 through 2018 by improperly blending EIA's Short-Term Energy Outlook ("STEO") and EIA's Annual Energy Outlook ("AEO"). AEPCO and defendants use the STEO to forecast fuel prices through 2011 and the AEO to forecast fuel prices after 2011. However, rather than use the actual fuel prices projected in the AEO, AEPCO calculates the percentage changes in price over the forecast period and applies them to prices in the STEO. Consequently, AEPCO's projected fuel prices from 2012 through 2018 are inconsistent with those in the AEO. On rebuttal, AEPCO argues that using the AEO prices produces a dip in fuel costs between the final year of the STEO (2011) and the first year of the AEO (2012). AEPCO Reb. at III-A-88 to A-90. However, AEPCO does not identify any flaw in the AEO that invalidates the fuel price forecast for 2012, and it does not explain why it is permissible to use the AEO's prices to calculate percentage increases while rejecting the prices themselves. The Board should reject AEPCO's mix-and-match creation of a new price index and accept defendants' evidence, which uses EIA's fuel price forecasts as EIA intended them to be used.

AEPCO also continues to overstate revenues for UP's non-coal traffic by relying upon UP's system-wide ratio of total revenues to total fuel surcharge revenues to allocate revenues between base rates and fuel surcharges. Defendants showed on reply that AEPCO could have allocated revenues more accurately using the same movement-specific information that AEPCO used to project future fuel surcharge levels. Joint Reply at III.A-64, A-70. AEPCO does not dispute that defendants' method is more accurate, or that AEPCO had already processed the movement-specific information and used it for a related purpose. Instead, AEPCO argues that because UP was not able to produce fuel surcharge information that met its precise specifications in discovery, it is entitled to rely on any reasonable proxy. AEPCO Reb. at III-A-98 & n. 60.[5] However, AEPCO did not use a reasonable proxy – AEPCO ignored readily available information in favor of a less accurate approach (that, not surprisingly, proved more favorable to AEPCO).[6] The Board should accept defendants' allocation of UP non-coal revenues between base rates and fuel surcharges.

[5] UP responded fully and accurately to AEPCO's discovery requests. If AEPCO had concerns about UP's discovery responses, it should have raised them at the time so they could have been discussed by the parties and, if necessary, resolved by the Board.

[6] AEPCO argues that using system-average data should not have biased the results of its analysis, AEPCO Reb. at III-A-99, but as defendants' analysis demonstrated, the relationship between fuel surcharges and base revenue for the traffic moving over the UP lines replicated by the SARR – primarily intermodal traffic – is in fact different than the relationship between fuel surcharges and base revenue for UP's traffic as a whole.

VI. AEPCO'S G&A STAFFING LEVELS ARE INFEASIBLE.

BNSF and UP developed a bottom-up analysis of ANR's minimum G&A staffing requirements using a scaling analysis that determined staffing requirements from real-world experience based on metrics such as railcar volume, revenue, assets, or miles of track. Joint Reply at III.D-34, D-38, D-40 to D-41, D-48. The Board accepted this basic approach in *Public Service Co. of Colorado d/b/a Xcel Energy v. Burlington Northern & Santa Fe Ry.*, 7 S.T.B. 589, 648 (2004). When defendants' results are measured against comparable Class I railroads, the proposed staffing levels for ANR are less than half the staff size of KCS, GTW, or SOO, which are comparable in tonnage, revenue, and size to ANR. *See* Joint Reply at III.D-73.

The main thrust of AEPCO's argument is that ANR should have smaller G&A staffing requirements because ANR is largely handling overhead traffic.[7] AEPCO Reb. at III-D-53, D-58, D-61 to D-62, D-65 to D-66, D-69, D-71, D-78. But AEPCO has no basis for the many assumptions underlying its argument – that overhead traffic is "substantially less 'G&A intensive,'" that "overhead traffic does not place as high a burden on customer service staff as local traffic," and that ANR would have "little if any marketing contact with customers." AEPCO Reb. at III-D-58, D-62, D-66, D-78. The SARR is an independent railroad. Like any independent railroad, ANR will require staff to perform functions such as interacting with service-sensitive intermodal customers, working with BNSF and UP marketing managers to ensure that timely rates are available to customers, and settling rates. Joint Reply at III.D-38 to D-41.

AEPCO further argues that the Board should accept its proposed staffing levels because they resemble staffing levels that the Board has accepted in other SAC cases. But ANR is very

[7] A similar argument was raised in *Seminole Electric Cooperative, Inc. v. CSX Transportation, Inc.*, STB Docket No. 42110.

different from other SARRs. The other SARRs primarily handled coal, served a limited set of customers, and did not handle any appreciable amount of intermodal traffic. By contrast, ANR has a far larger range of commodities, customers, and geographic regions than previous SARRs and will thus require additional G&A staff to perform the workload. In any event, the Board accepted G&A staffing that was even larger than BNSF's and UP's proposed staffing levels in *FMC Wyoming Corp. v. Union Pacific R.R.*, 4 S.T.B. 699, 835-841 (2000) (accepting G&A staff of 553 employees).

VII. MOW COSTS SHOULD INCLUDE THE INCREMENATAL MAINTENANCE COSTS ASSOCIATED WITH THE ABSENCE OF ACCESS ROADS.

In their reply evidence, defendants explained that $37.6 million should be added to ANR's MOW plan to reflect incremental costs associated with the absence of access roads used to maintain high density lines. Specifically, defendants' expert, Mr. Hughes, explained that a high density railroad such as ANR requires maintenance roads along the majority of the route, but that ANR does not include "any maintenance roads, except possibly for some sub-standard access roads in some limited areas along the Orin Line." Joint Reply at III.D-112.

In its rebuttal, AEPCO recites the arguments that complainants have raised to avoid the costs of constructing access roads in the first instance. However, defendants are making a different point: AEPCO may not be required to build access roads for its SARR, but if it does not, the SARR will incur incrementally higher maintenance costs. The Board has recognized in principle that railroads will incur higher maintenance costs in the absence of access roads. However, in prior cases, the Board has not accounted for those costs because the railroads did not quantify them. *E.g.*, *PSCo/Xcel*, 7 S.T.B. at 673 (BNSF failed to "quantif[y] how much operating or maintenance costs would increase without additional access roads"); *Otter Tail*, slip op. at D-8 (same).

Here, Mr. Hughes specifically addressed the evidentiary shortcomings in prior cases and presented extensive evidence quantifying the impact on ANR's maintenance costs from the absence of maintenance roads. Joint Reply at III.D-120 to D-121. He identified which MOW costs are directly affected by the absence of maintenance roads and how the categories of MOW costs would be affected by the absence of maintenance roads. He developed costs by performing a line-by-line evaluation of the labor, equipment, and annual MOW expenses. Joint Reply at III.D-118 to D-119. Thus, defendants have shown with detailed evidence the impact on maintenance costs from the absence of access roads along most of the ANR. The Board should accept defendants' incremental cost estimates.

VIII. THE BOARD SHOULD REJECT AEPCO'S MANIPULATION OF THE RAILROAD INDUSTRY COST OF CAPITAL.

AEPCO argues that it should be entitled to use two different methods for determining the SARR cost of capital. For 2008, AEPCO would ignore the Board's actual cost of equity determination for the railroad industry, and instead use a modified cost of equity estimate calculated using only CAPM. For 2009, however, the SARR would employ the actual railroad industry cost of equity as calculated by the Board, using the average of CAPM and MSDCF. AEPCO Reb. at III-G-1 to G-3. AEPCO admits that its approach is an outcome-based effort to select the lowest possible number. According to AEPCO, for 2008, the cost of equity generated by MSDCF "vastly exceeds" what AEPCO considers to be a reasonable level, so AEPCO rejects it. *Id.* at III-G-1. For 2009, the "disparity" between CAPM and MSDCF is "substantially less," and AEPCO believes the final average when published by the Board "will prove to be lower," so AEPCO is willing to accept the 2009 industry figure. *Id.* at III-G-3. Picking and choosing among possible cost of capital figures depending on which is the lowest cannot provide a reasoned basis for decision-making and must be rejected.

As defendants explained in their reply, it makes no sense for AEPCO to claim that the railroad industry is a valid proxy to use in estimating the SARR's cost of capital but then to use something other than the Board's official estimate of the railroad industry cost of capital. AEPCO's cost of capital evidence is yet another attempt to collaterally attack the Board's cost of capital determinations. The Board has decided that the use of a combined MSDCF-CAPM approach yields the best estimate of the railroad industry's cost of capital, and AEPCO should be required to use the Board's estimates based on that approach if AEPCO has accepted the railroad industry as a proxy for the SARR in estimating the cost of capital.

IX. THE BOARD SHOULD INCLUDE DEFENDANTS' EQUITY FLOTATION COSTS.

The Board accepted that an equity flotation fee is appropriate in *AEP Texas North Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No.1), slip op. at 108 (served Sept. 10, 2007) ("*AEP Texas 2007*"). Equity flotation costs are incurred by railroads when they raise equity and they would be incurred by any new entrant. Therefore, equity flotation costs should be fully reflected in the SAC analysis. As defendants demonstrated in their reply evidence, however, the manner in which the Board applied the equity flotation costs in *AEP Texas 2007* effectively negates the impact of those costs on the SARR. Joint Reply at III.G-5 to G-8. The SARR must be treated as incurring the entire equity flotation fee to mirror the costs that a real railroad would incur. By spreading the flotation costs incurred by the SARR over the entire railroad industry, including railroads that incurred no equity financing costs in that particular year, the Board's approach in *AEP Texas 2007* artificially dilutes the impact of those costs on the SARR. This problem does not arise in the context of fees incurred by the SARR to incur debt precisely because debt flotation fees are regularly incurred by all railroads and therefore are reflected in the railroad industry cost of debt.

AEPCO does not address the way in which equity flotation costs should be estimated but rather claims that *AEP Texas 2007* does not support the inclusion of any equity flotation costs. AEPCO's argument is that equity flotation costs were imposed in *AEP Texas 2007* only because AEP Texas wanted its SARR to refinance. AEPCO Reb. at III-G-13 to G-14. AEPCO's claim is flatly contradicted by the Board's decision concerning technical corrections in that case: "The equity flotation costs included in the *Sept. 2007 Decision* were incurred as part of the original financing of the SARR and are separate from the equity flotation costs associated with refinancing. These costs should therefore be included in the cost of equity calculated for the SARR." *AEP Texas 2009*, slip op. at 23.

X. THE BOARD SHOULD USE ANR'S URCS COSTS WHEN APPLYING ITS MMM METHODOLOGY FOR DETERMINING MAXIMUM REASONABLE RATES.

The Board has never applied its MMM methodology in a case involving joint-line rates, but MMM's conceptual underpinnings and defendants' evidence make clear that, if the Board carriers out the SAC analysis based on AEPCO's ANR configuration, it should use ANR URCS costs, not BNSF and UP URCS costs to determine maximum reasonable rates in this case.[8]

As defendants explained on reply, the objective of MMM is to allocate responsibility for the SARR's costs to SARR shippers based on the "relative share of service provided" by the SARR for each movement. *Major Issues*, slip op. at 9. AEPCO's claim that the focus of MMM should be "on the defendants, as opposed to the SARR" ignores the purpose of MMM. AEPCO Reb. at III-H-14, H-16. MMM seeks to allocate responsibility for the SARR's costs to the users

[8] The Board need not address this issue if it carries out the SAC analysis using defendants' ANR-PRB and ANR-NM configurations because the challenged rates do not exceed reasonable levels when they are evaluated using properly configured SARRs. *See* Joint Reply at III.H-10.

of the SARR. The "relative share of service provided" by the SARR has to be determined based on the costs that the SARR incurs to provide the service, not based on the defendant's costs.

In *Major Issues*, the Board adopted the use of defendants' URCS to simplify calculation of the "relative share of service provided," but the defendants' URCS are plainly a proxy for the SARR's URCS. Defendants' evidence in this case demonstrates that using defendants' URCS in a case involving joint-line rates, particularly where the SARR has a diverse traffic group, is not a reasonable proxy for the SARR's URCS. For example, defendants showed that coal traffic receives a much larger "share of the services provided" by ANR, and thus should be allocated a much larger share of ANR's SAC costs. Joint Reply at III.H-13 to H-15. AEPCO claims that defendants' "larger purpose is to funnel relief away from the coal traffic toward the non-coal traffic." AEPCO Reb. at III-H-21. But the use of ANR's URCS simply reflects the costs of the SARR designed by the complainant, which is assumed to handle intermodal traffic at a very low cost to the SARR and to handle coal at a significantly higher cost. Use of defendants' URCS, which do not reflect such a wide disparity in costs for the different traffic groups, would produce an inaccurate allocation of SAC costs to the ANR traffic based on the "share of service provided." Defendants also showed that allocating ANR's SAC costs correctly would have a significant impact on MMM calculations, as well as any cross-subsidy analysis. Joint Reply at III.H-16 to H-17.

AEPCO argues that the use of ANR's URCS produces a number of inconsistencies in the SAC analysis. First, AEPCO argues that the use of ANR's URCS in MMM would be inconsistent with using defendants' cost and traffic data in ATC. AEPCO Reb. at III-H-14. But ATC and MMM are different methodologies designed to do two different things. ATC determines the amount of the defendants' revenues that the SARR can be assumed to receive.

The focus is supposed to be on the defendants, whose revenues are being allocated to on-SARR and off-SARR portions of the defendants' movements. The SARR's variable costs are not relevant. In contrast, the objective of MMM is to allocate the SARR's revenue requirement among SARR users based on the SARR's costs to provide service. The defendants' costs are not relevant. Use of defendants' costs in the MMM inquiry would be appropriate only to the extent those costs are a valid proxy for the SARR's costs, which defendants have shown is not the case here.

AEPCO also argues that the ANR's URCS costs are inconsistent with defendants' URCS costs because the ANR's URCS costs are based on the replacement costs of road property assets while the defendants' URCS costs are based on the book value of those assets. AEPCO Reb. at III-H-18. In fact, the ANR's URCS developed by defendants use the book value of the ANR's assets in the same way that asset values are used to develop the defendants' URCS costs. Because the ANR is a new facility, those costs reflect replacement costs. ANR is a new railroad operating with a new asset base, and the use of the ANR's URCS reflects the efficiencies associated with the operations of such a railroad.

Finally, AEPCO claims that "one could not properly apply the overstated ANR URCS MMM ratio to the variable costs of the defendants" in establishing the rate prescription using MMM. AEPCO Reb. at III-H-20. AEPCO states, incorrectly, that "BNSF/UP avoid any mention of this issue." *Id.* In fact, as defendants explained, MMM allocates the responsibility for the SARR's costs to each user of the SARR and identifies the amount of revenue that each movement must contribute to cover the SARR's costs. The revenue requirement for the issue traffic movement can be translated directly into an R/VC ratio and used to determine a prescribed rate by using the revenue requirement calculated by MMM as the numerator and the defendants' URCS costs as the denominator. Joint Reply at III.H-15. There is no inconsistency between the MMM allocation of SAC costs to the SARR's traffic and the prescription of an R/VC ratio based on the defendants' URCS costs.

XI. THE BOARD SHOULD NOT ALLOW AEPCO TO MISUSE REBUTTAL AS AN OPPORTUNITY TO SUBMIT NEW EVIDENCE.

In many instances, AEPCO's rebuttal includes evidence to which defendants have had no opportunity to reply. In some cases, AEPCO offers alternative reasons for accepting its position on opening after acknowledging valid criticisms of that position from defendants. For example:

- AEPCO acknowledges that its fuel costs for West Vaughn and West El Paso yards reflected fuel deliveries by pipeline, even though no pipelines serve those locations, but submits new evidence purporting to show that pipelines could be built to supply fuel for even lower costs than it initially assumed. AEPCO Reb. at III-D-6 to D-17.
- AEPCO acknowledges that its proposed outsource provider for ANR's marketing and customer service is not currently capable of handling a project the size of ANR, but asserts that the provider could increase staffing as necessary. *Id.* at III-D-62.

In other cases, AEPCO's rebuttal purports to chart an intermediate course – AEPCO accepts defendants' criticism as valid but offers an alternative to its own opening evidence and defendants' reply evidence. For example:

- AEPCO acknowledges that it incorrectly excluded certain outages on BNSF lines from its original RTC simulation, but submits new evidence explaining why it accepted certain additional outages and excluded others. *Id.* at III-C-34 to C-38.
- AEPCO acknowledges that it incorrectly calculated fuel consumption rates for ANR's trains based on system-average BNSF and UP URCS fuel consumption factors, but rather than accepting locomotive-specific data submitted by defendants, it submits new evidence regarding purported locomotive fuel efficiencies that it uses to adjust defendants' calculations. *Id.* at III-D-18 to D-20.
- AEPCO acknowledges that ANR's insurance costs should reflect costs for smaller rail systems, not BNSF, but it submits new evidence regarding costs for a different set of smaller railroads than defendants used in their reply. *Id.* at III-D-157 to D-159.

- AEPCO acknowledges that it did not correctly calculate the required amount of subballast, but it submits new evidence using a new methodology rather than accepting the corrections defendants made in their reply. *Id.* at III-F-59.

When AEPCO acknowledges a flaw in its opening evidence and offers new evidence on rebuttal to support the same result, or to support an alternative to both its own opening evidence and defendants' reply evidence, the Board should accept defendants' evidence unless AEPCO demonstrated that defendants' reply evidence "is itself unsupported, infeasible, or unrealistic." *Duke Energy*, 7 S.T.B. at 101 (2003). The Board should apply this principle strictly so complainants will clearly understand that they must present their full case on opening.

Finally, when AEPCO acknowledges that its opening evidence does not account for a cost, and it does not attempt to correct the cost evidence submitted by defendants, the Board must accept the evidence submitted by defendants. The clearest example in this case involves costs to implement PTC. AEPCO does not challenge defendants' cost calculations; rather, it argues that the Board concluded in *US Magnesium* that PTC costs were too uncertain to be estimated. AEPCO Reb. at III-C-50. However, *US Magnesium* was a Three-Benchmark case in which the issue was whether PTC costs were sufficiently certain and sufficiently attributable to the complainant to support a special *adjustment* to a presumed maximum lawful rate determined using the Three-Benchmark method. Here, PTC costs are not being used to adjust a presumed maximum lawful rate, and there is no issue of attributing PTC costs a particular shipper. Here, PTC costs are an indisputable part of the costs of constructing a SARR, and because AEPCO has presented no evidence on the issue, the Board must accept the evidence presented by defendants.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of July, 2010, I caused a copy of the foregoing Final Brief of Defendants BNSF Railway Company and Union Pacific Railroad Company to be served on the following Parties of Record by hand delivery:

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