

STB DOCKET NO. 42058

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
v.
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY
COMPANY AND UNION PACIFIC RAILROAD COMPANY

Decided August 19, 2002

The Board provides guidance on the permissible contours of a stand-alone cost presentation involving coal shipments from three separate and distinct mining regions.

BY THE BOARD:

On December 29, 2000, Arizona Electric Power Cooperative, Inc. (AEPCO or complainant) filed a complaint challenging the reasonableness of joint rates of The Burlington Northern and Santa Fe Railway Company (BNSF) and Union Pacific Railroad Company (UP) (collectively, defendants) for unit-train movements of coal from mines at North Tipple and Lee Ranch, NM, to AEPCO's Apache Generating Station in Cochise, AZ. On March 9, 2001, AEPCO amended the complaint to also challenge joint BNSF-UP rates to Cochise from BNSF-served mines in the Powder River Basin (PRB) of Wyoming and Montana,¹ and UP rates for single-line service from UP-served mines in Colorado.

Because the three sets of challenged rates are for service from separate coal-producing areas hundreds of miles apart, moving over lines with different physical characteristics and traffic patterns, as well as moving in different types

¹ Defendants had canceled their joint PRB-Cochise rates in June 2001, on the ground that AEPCO had contracted to satisfy its 2001 coal needs from New Mexico and Colorado mines, making shipments from the PRB unlikely at that time. At AEPCO's request, we ordered defendants to reestablish PRB-Cochise rates, in a decision in this proceeding served December 31, 2001 (*Dec. 2001 Decision*). Defendants have complied with that order, but have also sought judicial review of that requirement in *Burlington N. & S.F. Ry. v. STB*, No. 02-1054 (D.C. Cir. filed February 11, 2002). The railroads state that no coal has moved under the restored PRB rates and that AEPCO continues to fully satisfy its coal requirements from the New Mexico and Colorado mines.

of service (two in joint-line service and the other in single-line service), defendants filed a petition on February 15, 2002, asking that we direct AEPSCO to make separate evidentiary submissions—including separate stand-alone cost (SAC) presentations—for each of the three sets of challenged rates. The defendants' petition raises novel issues that require our guidance on the permissible parameters of a SAC presentation in these circumstances.

BACKGROUND

The purpose of the SAC test, like the other measures of Constrained Market Pricing (CMP),² is to enable us to judge the reasonableness of the rate(s) charged by defendant carrier(s) for providing service to the complainant.³ The SAC test accomplishes this by allowing us to determine what a hypothetical carrier would need to charge for the level of service demanded by complainant after removing costs associated with inefficiencies or inappropriate cross-subsidies. *Guidelines*, 1 I.C.C.2d at 528, 542-46.

In a SAC analysis, the complaining shipper's presentation is not limited by how the defendant carrier conducts its operations. The shipper may hypothesize a different, more efficient means of transporting the traffic at issue, which may

² CMP was adopted, as our guidelines for assessing the reasonableness of challenged rail rates, in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985) (*Guidelines*), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). The principles of CMP can be simply stated. A shipper should not be required to pay more than is necessary for the carrier involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. A shipper should not bear the cost of any facilities or services from which it derives no benefit. And responsibility for payment for joint and common costs associated with facilities or services that are shared by other shippers should be apportioned according to the demand elasticities of the various shippers using them. *Guidelines*, 1 I.C.C.2d at 523-24.

³ CMP provides alternative methodologies for addressing the same basic inquiry: what would an efficient carrier need to charge in the absence of any cross-subsidies. *Guidelines*, 1 I.C.C.2d at 534, 542, 547-48. The "top-down" method approaches this task by analyzing the defendant carrier's existing system, operations, and practices in an effort to root out unnecessary costs resulting from specifically identified inefficiencies and cross-subsidies. In contrast, the "bottom-up" approach embodied in the SAC test approaches the task by designing a hypothetical, totally new and optimally efficient carrier and determining what that carrier would need to charge for providing service to the complaining shipper. *McCarty Farms, et al. v. Burlington Northern, Inc.*, 2 S.T.B. 460, 466-67 (1997) (*McCarty*); *CF Industries, Inc. v. Koch Pipeline Company, L.P.*,⁴ S.T.B. 637 (2000) at 642-43. Rail shippers have generally preferred to use the bottom-up (SAC) approach, finding it easier and more effective to analyze a selected subset of rail operations rather than a large railroad's entire system, and to hypothesize a new rail system rather than demonstrate that the defendant carrier's existing operations are inefficient and should be changed.

include a longer route to take advantage of higher traffic densities. *Guidelines*, 1 I.C.C.2d at 543-44. In view of the substantial production economies that characterize the rail industry, *id.* at 526-27, complainants usually find it to their benefit to add other, “non-issue” traffic⁴ to a stand-alone railroad (SARR) in order to reduce the complainant’s share of what would be transformed into joint and common costs of the carrier’s operations, *id.* at 543-44.

It is essential, however, to distinguish between cost-sharing (the grouping of traffic to share joint and common—i.e., unattributable—costs), which is permissible under our SAC test, and cross-subsidization (the recovery of any shipper’s attributable costs from other shippers), which is not. *PPL Montana, LLC v. Burlington Northern & Santa Fe Railway Co.*, 6 S.T.B. 286 (2002) at 294-96. As we explained in addressing various discovery issues in this proceeding, revenues from non-issue traffic should not be relied upon to contribute to the costs of line segments or facilities that the non-issue traffic would not use. *Dec. 2001 Decision* slip op. at 6.

POSITIONS OF THE PARTIES

The petition before us voices the defendants’ continued concerns that AEPCO intends to present SAC evidence based on a single, unified SARR serving all three coal origin areas and that such a unified approach would include cross-subsidies in contravention of SAC principles. Defendants first assert that the non-issue traffic to be included in the traffic group of a SARR designed to test the reasonableness of UP’s single-line rates (for AEPCO’s movements from the Colorado mines) must be confined to UP’s own traffic base and may not include any BNSF traffic. Otherwise, they argue, the result of the SAC analysis could be to improperly require UP to set its single-line rates for the Colorado traffic as if a share of the costs associated with the single-line service were borne by traffic that UP does not carry, from which UP does not receive revenues, and for which UP cannot set the rates. *Petition (Pet.)* at 1-2, 7-10.

Second, defendants assert that the vast majority of BNSF’s coal traffic from the PRB would be irrelevant to any assessment of the reasonableness of the New Mexico and Colorado coal rates because most PRB traffic moves east and southeast and thus shares few facilities with AEPCO’s New Mexico and Colorado coal traffic (which moves south). Moreover, because the PRB is characterized by extremely heavy traffic, while the New Mexico and Colorado

⁴ Non-issue traffic is all of the traffic included in a SARR traffic group other than the traffic to which the challenged rate(s) apply.

lines are more lightly used, defendants claim that in a combined SAC analysis the reasonableness of the New Mexico and Colorado rates could be driven by our assessment of the reasonableness of the PRB rates.⁵ Pet. at 14. Defendants state that our assessment of the New Mexico rates would also be improperly distorted should AEPCO include in the non-issue traffic group large volumes of UP Colorado coal traffic that moves east toward Kansas City, as the latter traffic assertedly shares none of the facilities associated with the New Mexico traffic. Pet. at 14-15.

Third, defendants argue that separate SAC presentations are needed to avoid the added costs, delays, and burdens that would be associated with refiling SAC evidence should the defendants succeed in having the portion of the amended complaint relating to rates from the PRB dismissed due to AEPCO's non-use of those rates. Pet. at 11-12, 15-19.

On reply, AEPCO confirms that it is contemplating a linked, three-part SARR, but claims that its SARR would comport fully with SAC principles. Complainant states (Reply at 8-10) that its unified SARR would test the reasonableness of:

(1) the BNSF-UP joint-line rates for the New Mexico coal traffic using a sub-SARR that, to take advantage of traffic densities, may apparently replicate an alternative route—a BNSF route from the New Mexico mines east to or near Vaughn, NM (rather than the BNSF route south to Deming, NM, where BNSF currently hands this traffic over to UP) and UP's route from Vaughn south to El Paso, TX, and then west (via Deming) to Cochise—with the SAC rate for AEPCO's New Mexico traffic to be determined by examining the revenues and costs of that sub-SARR only;

(2) the UP single-line rates for the Colorado coal traffic using a second sub-SARR that would replicate UP's route from the Colorado origins to a junction point on the New Mexico sub-SARR, with the SAC rate for AEPCO's Colorado traffic to be determined by examining the combined revenues and costs of the first and second sub-SARRs; and

(3) the joint BNSF-UP rates for PRB coal using a third sub-SARR that would replicate one of BNSF's routes from the PRB origins to a junction point with the Colorado sub-SARR, with the SAC rate for AEPCO's PRB traffic to be determined by examining the combined revenues and costs for all three sub-SARRs.

AEPCO asserts that this three-tiered approach would avoid cross-subsidy issues by making the SAC calculations for the issue traffic from each of the three mine areas based only on traffic that shares common facilities. It reasons that, with this incremental approach to the SARR, its New Mexico coal traffic would

⁵ That result, defendants argue, would be particularly inappropriate given that AEPCO has only moved one trainload of coal from the PRB. Pet. at 14.

not be subsidized by Colorado or PRB coal traffic, nor the Colorado coal traffic by PRB traffic. Reply at 2-3, 10. AEPCO further asserts that requiring three separate SAC presentations would needlessly increase litigation costs, and it notes that separate presentations would necessarily contain some duplication, as each SARR would have at least the Deming-to-Cochise line segment in common.

AEPCO argues that the traffic group of the sub-SARR used to test the UP single-line rates for the Colorado coal traffic should not be restricted to UP's traffic base. Reply at 11-15. Complainant reasons that BNSF now uses three segments of the UP single-line route, through joint ownership and trackage rights arrangements; that revenues generated by both BNSF and UP traffic thus contribute to the costs of the jointly used segments; and that AEPCO should be able to enjoy these economies for its shipments from the Colorado origins. Reply at 11.

Complainant also asserts that, because a BNSF predecessor—the Atchison, Topeka & Santa Fe Railway (ATSF)—formerly served as a bridge carrier for AEPCO's Colorado coal shipments,⁶ AEPCO should not be precluded from adding BNSF traffic to the non-issue traffic group simply because UP now chooses to use a single-line routing that AEPCO asserts is less efficient. Reply at 11-12. And, pointing to the broad flexibility that a complainant generally has to design a least-cost, efficiency optimizing SARR, AEPCO argues that it should be able to use a sub-SARR that would avoid the duplication and claimed inefficiencies of the current BNSF and UP systems by hypothesizing a routing of the Colorado traffic over a SARR that would also handle BNSF traffic. Reply at 12-15.

Finally, complainant submits that removal of one part of the combined SARR (for jurisdictional or other reasons) should not necessitate the refiling of evidence, cause delay, or otherwise undercut its remaining challenges. Reply at 16-17. But even if its challenge to the PRB coal rates were to be dismissed, AEPCO asserts that it should still be able to include those portions of PRB-originated movements (with prorated revenues) that use the Colorado and New Mexico segments of the SARR. Reply at 17-20.

⁶ The traffic was originated and delivered by a UP predecessor, the Southern Pacific Transportation Company (SP). Reply at 12.

DISCUSSION AND CONCLUSIONS

As AEPCO correctly states, our CMP guidelines do not prescribe a hard-and-fast formula for making a SAC presentation; rather, they afford a complainant considerable flexibility, at the outset, to develop a SAC presentation best tailored to its case. *Guidelines*, 1 I.C.C.2d at 546. That discretion, however, is not unlimited. Any SAC presentation must necessarily be grounded in, and bounded by, what is reasonable and appropriate to serve the purpose of the SAC test. Thus, the assumptions and selections that a party makes for its SARR—including those involving grouping of non-issue traffic—are open to challenge and scrutiny. *Guidelines*, 1 I.C.C.2d at 543 n.61, 544.

While we generally resist placing limitations on SAC presentations in advance and in the abstract,⁷ some guidance and direction is necessary and appropriate at times. Here, the contemplated SARR contours have been identified with some specificity; there are strong and clearly defined differences between the parties, with resulting uncertainty, regarding the propriety of those contours; and the parties have had an adequate opportunity to address the relevant issues. Accordingly, we will provide needed guidance here.

As noted above, the route AEPCO contemplates using for the sub-SARR designed to test the joint-line rates for its New Mexico coal traffic (BNSF-Vaughn/UP-Cochise) is not the route that the defendants currently use (BNSF-Deming/UP-Cochise). But BNSF and UP are themselves free to alter or vary their routing of AEPCO's movements in this manner at any time (by mutually changing the interchange point) without needing AEPCO's consent and without affecting the joint rate charged to (and challenged by) AEPCO. Therefore, basing a SAC presentation on such an alternative routing for the issue traffic would seem to be permissible, so long as AEPCO has not itself specifically requested the routing that the defendants currently use.

In contrast, joint UP-BNSF service could not be provided for AEPCO's shipments from the Colorado mines under the UP single-line rates that are the subject of AEPCO's challenge. Therefore, it would be inappropriate to judge the reasonableness of the single-line rate as if the traffic moved over a two-carrier routing. Neither the fact that a BNSF predecessor may have participated in moving Colorado coal to AEPCO in the past, nor that the UP single-line route may be longer than the previous SP-ATSF-SP routing, alters this basic principle.

⁷ See *Guidelines*, 1 I.C.C.2d at 543 n.61, 544; *PPL Montana, LLC v. Burlington Northern & Santa Fe Railway Co.*, 5 S.T.B. 1105 (2001) at 1110-11.

SP has merged into UP, and the merged carrier is entitled to provide single-line service and to have its single-line rates judged as such.

It would be equally inappropriate for complainant to include non-UP traffic in the traffic group of any part of a SARR aimed at testing UP's single-line rates for the Colorado coal traffic. UP's single-line rates should not be judged as if UP has the benefit of revenues from traffic in which it does not participate. Just as our SAC analyses do not include types of costs not incurred by the defendant carrier,⁸ they should not include revenues not received by the defendant carrier.

AEPCO invokes the economic theory of contestable markets,⁹ in which the SAC constraint is rooted, to argue that there should not be any traffic restrictions or limitations on efficient alternatives to existing systems in a SAC analysis. But our SAC constraint is meant to serve as a practical tool, not a mere exercise in contestable market theory divorced from its purpose of judging the reasonableness of the defendant carrier's pricing. When the purpose of the SAC exercise is taken into consideration, it becomes clear that a defendant carrier's ability to recover reasonable costs and earn adequate revenues should not be limited by the inclusion in our rate reasonableness analysis of another carrier's traffic and revenues that do not or could not reasonably be expected to pay for the defendant carrier's costs. *Guidelines*, 1 I.C.C.2d at 534. In short, there are limits on the creativity with which a complainant such as AEPCO may develop its SARR.

On the other hand, where UP has cost-sharing arrangements in place with BNSF (for example, joint ownership of a line-segment or trackage rights arrangements), it is entirely appropriate to assume that the SARR would have the benefit of the same opportunities under the same terms as UP enjoys. *See, e.g., West Texas Utilities Company v. Burlington Northern RR Co.*, 1 S.T.B. 638, 673 n.74 (1996); *WP&L*, at 1014. As AEPCO points out, BNSF has trackage rights over the Bond, CO–Denver portion of the route UP uses for the Colorado coal traffic and pays a trackage rights fee to UP that helps defray UP's costs for that segment; the Pueblo, CO–Stratford, TX segment is a BNSF-owned line for which UP pays BNSF a trackage rights charge; and the Denver–Pueblo segment

⁸ *See Burlington N. R.R. v. STB*, 114 F.3d 206, 214 (D.C. Cir. 1997); *Arizona Public Service Co. v. Atchison, T. & SF. Ry. Co.*, 2 S.T.B. 367, 386 (1997); *Wisconsin Power & Light v. Union Pacific Railroad Company*, 5 S.T.B. 955 (2001) at 1024-25 (*WP&L*); *McCarty*, 2 S.T.B. at 504 & n.81.

⁹ By removing costs associated with entry and exit barriers, contestable market theory allows for the simulation of a competitive price by calculating what a hypothesized efficient producer would need to charge to provide replacement service. *Guidelines*, 1 I.C.C.2d at 528-29.

in between is a jointly owned line in which the carriers share costs. In designing a SARR to replicate UP's single-line service, AEPCO may assume these same economies. However, the fact that these arrangements exist in some places (either as a result of mutually beneficial voluntary agreements or merger conditions that we have imposed to preserve pre-merger competitive alternatives) does not mean that AEPCO is free to hypothesize additional (nonexistent) shared-use arrangements in other places, as it suggests (Reply at 14-15). Because UP could not unilaterally create such arrangements, its rates should not be judged as if these arrangements were available to it.

These guiding principles—that a SARR may replicate the existing cost-sharing arrangements but may not hypothesize non-existent revenue or cost-sharing arrangements—apply with equal force to SARRs designed to test the BNSF-UP joint rates from the PRB and New Mexico origins. Thus, for 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. But the SARR may be assumed to have the same cost-sharing arrangements as the defendant carriers have on each segment, so long as the terms of those arrangements (including operational provisions and terms of compensation) are the same as those applicable to the defendant carriers.

We now turn to the defendants' second concern, regarding the potential distorting effect of including PRB traffic that shares few facilities with the New Mexico and Colorado traffic in a combined SAC analysis. AEPCO states that it will adhere to our directive in the *Dec. 2001 Decision* that its SAC presentation not rely on revenues from non-issue traffic to pay for portions of a SARR's system over which that traffic would not move. Reply at 2, 7-8. Thus, AEPCO indicates that it would include in the sub-SARR testing the New Mexico rates only the portion of BNSF's non-issue PRB traffic (and prorated revenues) traversing the New Mexico, West Texas, and Arizona line segments to be replicated. Reply at 10, n.8. Similarly, AEPCO should include in the New Mexico traffic group only the portion of UP's non-issue Colorado coal traffic (and prorated revenues) moving over these line segments.

Finally, addressing the defendants' third concern, we see no reason why a complainant should not be able to use some form of a combined sub-SARR approach, if it conforms to the parameters described above. Of course, a party is not permitted to "game" the SAC process in attempting to gain a substantive advantage by combining into a single, consolidated complaint what are essentially three separate rate challenges. Thus, for each of the three sets of challenged rates, AEPCO may not include any traffic or revenues (or exclude

any costs) that could not have been treated in the same manner had AEPCO filed a separate complaint for that set of rates. Adherence to these basic principles should obviate the defendants' concern over potential delays in our administration of the case and any need for revised evidence should any portion of the combined complaint ultimately be dismissed.

Accordingly, AEPCO may pursue relief using a three-part SARR, but it must follow the guidance set forth in this decision. Within the parameters outlined, we expect the parties to now proceed with discovery and the submission of evidence.

It is ordered:

1. The defendants' petition is denied. Complainant's SAC presentation, however, should be consistent with the principles outlined herein.
2. This decision is effective on its date of service.

By the Board, Chairman Morgan and Vice Chairman Burkes.