STB DOCKET NO. 41185

ARIZONA PUBLIC SERVICE CO. & PACIFICORP
v.
THE BURLINGTON NORTHERN AND SANTA FE
RAILWAY COMPANY

Decided December 13, 2004

In *Arizona Pub. Serv. Co. & Pacificorp v. The Burlington N. & S. F. Ry. Co.*, 6 S.T.B. 851 (2003) (*2003 Reopening*), the Board reopened this proceeding so the parties could submit evidence on how the impending shutdown of the McKinley mine would impact the stand-alone cost (SAC) analysis adopted by the Board in the decision reported at *Arizona Pub. Serv. Co. and Pacificorp v. The Atchison, Topeka and S. F. Ry. Co.* 2 S.T.B. 367 (1997) (*1997 Decision*), as revised in the decision reported at *Arizona Pub. Serv. Co. and Pacificorp v. The Atchison, Topeka and S. F. Ry. Co.* 3 S.T.B. 70 (1998) (*1998 Decision*). The updated evidence submitted on reopening shows that the changed circumstances have such a profound effect on the SAC analysis upon which the previous rate prescription was based that the prescription should be vacated and the proceeding dismissed.

BY THE BOARD:

BACKGROUND

In 1994, Arizona Public Service Company and PacifiCorp (jointly, Arizona) filed a complaint challenging the reasonableness of the rate charged by the predecessor of The Burlington Northern and Santa Fe Railway Company (BNSF)[1] for transportation of coal from the McKinley mine of the Pittsburgh & Midway Coal Mining Company (P&M), near Gallup, NM, to Arizona's Cholla Station electric generating plant near Joseph City, AZ (Cholla). In the *1997 Decision*, as revised by the *1998 Decision*, the Board found the challenged rate to be unreasonably high and prescribed maximum reasonable rate levels.

The Board's rate analysis was based on the SAC methodology developed 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 objective of a SAC analysis is to simulate the competitive rate that would be available to the captive shipper in a contestable market environment. *Guidelines*, 1 I.C.C.2d at 528-34.

In a SAC analysis, we determine, based on the record developed by the

[1] The original defendant in this proceeding, The Atchison, Topeka and Santa Fe Railway Company, has since merged with the Burlington Northern Railroad Company to form BNSF. This proceeding has been recaptioned, and we refer to the defendant as BNSF.

parties, what a hypothetically efficient "stand-alone railroad" (SARR) would need to charge a selected traffic group, free from any costs associated with inefficiencies or cross-subsidization of other traffic, to earn a reasonable return on its invested capital. The SARR is designed to serve the identified traffic group using the optimum physical plant or rail system needed for that traffic. A computerized discounted cash flow (DCF) model simulates how the SARR would likely recover its capital investments over time, taking into account inflation, tax liabilities, and a reasonable rate of return. The annual capital costs are combined with the annual operating expenses to calculate the annual revenue requirements of the SARR.

We also determine, based on the parties' evidence, the annual revenues that the defendant carrier is expected to earn from the selected traffic and compare those to the annual revenue requirements of the SARR to determine the over- or under-recovery for each year. Because the SAC analysis period is lengthy, a present value analysis is used that takes into account the time value of money, netting annual over-recovery and under-recovery as of a common point in time. If there would be a net under-recovery for the entire analysis period (i.e., the revenues from the traffic group are less than the revenue requirements of the SARR), then the challenged rates are considered reasonable. If, on the other hand, there would be a net over-recovery (i.e., the defendant carrier earns more from the traffic group than the revenue requirements of the SARR), then the challenged rates are unreasonable and the rates that the defendant carrier may charge for the traffic at issue in the complaint are limited to what the SARR would need to charge to avoid an over- or under-recovery.

Applying the SAC test, Arizona designed a SARR that would replicate BNSF's line from McKinley to Cholla and connect with an existing private spur line serving the electric generating plant of the Salt River Project Agricultural Improvement and Power District at Coronado, AZ (Salt River). While Arizona could have selected any reasonable subset of existing BNSF traffic to move over the SARR (*see Guidelines*, 1 I.C.C.2d at 544), it chose to include only coal moving from McKinley to the Cholla and Salt River plants. *See 1997 Decision*, 2 S.T.B. at 381.

Under the SAC methodology, the level of a rate prescription depends on, among other factors, the total revenues projected to be earned from the specified traffic group and the distribution of the SARR's capital costs over the time period chosen for the SAC analysis (here, the 20-year period 1994-2013). Traffic projections are often a source of dispute in SAC cases, and this case was no exception. A major issue in the case was whether the McKinley mine would run out of coal before the end of the SAC analysis period (2013). While the McKinley coal reserves were expected to run out in 2007, P&M was engaged in contract negotiations to acquire new coal reserves on adjacent Navajo lands and expected those negotiations to be successful. Given that prediction, the Board concluded that coal would likely continue to be available from the McKinley area through the end of the SAC analysis period, thus making it unnecessary to account for Arizona and Salt River switching to other coal sources. *1997 Decision*, 2 S.T.B. at 384.

The Board recognized that the predicted availability of coal from Navajo lands could prove inaccurate. But the Board could not determine at that time whether or how the traffic patterns of Arizona and Salt River might change as a result of future depletion of reserves at McKinley. The Board concluded that its regulatory responsibilities were best met by assuming a continuation of the status quo, as "we can reopen this proceeding [should Arizona no longer be able to obtain coal from the McKinley area] * * * and, if necessary, determine what a reasonable rate would be under the changed circumstances." *1997 Decision*, 2 S.T.B. at 385. In the *1998 Decision*, the Board reaffirmed its determination to "assum[e] continuation of the status quo * * * unless and until shown to be an unreasonable assumption." *1998 Decision*, 3 S.T.B. at 79-80.

In January 2003, BNSF filed a petition asking the Board to reopen this proceeding and to vacate the rate prescription, based on evidence that: (1) the McKinley mine will exhaust its reserves well before the end of the 20-year SAC analysis period; (2) P&M will be unable to replace McKinley mine coal with coal from the Navajo Nation due to its high sulfur content; and (3) actual movements of coal from that mine to Cholla in recent years had not reached previously predicted levels.

Arizona did not dispute those assertions and agreed that the proceeding should be reopened to take into account the anticipated closure of the McKinley mine and the inability to substitute coal from the nearby Navajo Nation. However, Arizona objected to vacating the prescription, asserting that an updated and revised SAC analysis would yield a maximum reasonable rate even lower than the previously prescribed rate. Arizona asked to revise the SAC analysis not only to take into account the changes identified by BNSF, but also to take into account other changes that have occurred since 1998, to expand the traffic group, and to reconfigure the SARR. BNSF objected that broad changes to the original SAC analysis would be tantamount to submitting a new case.

The Board agreed with the parties that the proceeding should be reopened, but concluded that the scope of the reopening should be neither as limited as BNSF envisioned nor as broad as Arizona would have preferred. The reopening was not restricted to analyzing the effect of traffic loss due to depletion of the McKinley mine. Rather, the parties could submit evidence on how the Cholla and Salt River plants will re-source their coal needs once McKinley shuts down, what portion of that traffic could move over the SARR, and the revenues and costs associated with the SARR handling that re-sourced traffic. Moreover, the parties could update the record regarding forecasts included in the prior decisions that have since proven to have been inaccurate — including forecasts of inflation, the cost of equity capital, and traffic volumes and revenues for the Cholla and Salt River coal traffic. However, the parties were not allowed to reargue the base costs to which the forecasts had been applied, and Arizona was not allowed to redesign the SARR or to include new traffic (other than the re-sourced coal traffic destined to the Cholla and Salt River plants).

The Board explained that it is not appropriate to bring an entirely new (redesigned) rate case under the guise of a reopening. Rather, a reopening for substantially changed circumstances is intended to address such matters as projections in the original decision that have proven to have been seriously inaccurate. If a shipper wishes to present a redesigned SAC analysis, its recourse is to relinquish the rate prescription, thereby restoring the railroad's rate setting discretion, and then file a complaint challenging the railroad's new rate. *2003 Reopening*, 6 S.T.B. at 856 n.7.

The Board provided interim relief in *2003 Reopening* to prevent irreparable harm during the time it would take to complete the reexamination of the SAC analysis and determine what would be the appropriate level of a rate prescription, if any, for future shipments. The Board removed the prescriptive effect of the prior rate order, because the agency no longer had confidence in the level of the rate prescription. But it did not allow BNSF to collect a higher rate. (At that time, the level of the prescribed rate was $4.21 per ton, and BNSF had announced that, if the rate prescription were vacated, it would raise its rate immediately to $6.91 per ton.) Rather, the Board ordered the parties to maintain the status quo, keep account of the amounts paid, and, at the completion of the reopened proceeding, make the other party whole for any sums that might ultimately prove to have been needlessly forgone or overpaid in the interim.

On reopening, Arizona filed opening evidence; BNSF filed reply evidence; Arizona filed rebuttal evidence; and both parties later filed revised exhibits and tables. The parties also filed briefs, and on September 29, 2004, the Board heard argument.

DISCUSSION AND CONCLUSIONS

The New Evidence

In their submissions on reopening, the parties do not agree on the revised revenue and cost figures to use, either for what is now the historical period (1994-2002) or for the new forecast period (2003-2013).

For what is now the historical period, the disagreement concerns the extent to which re-sourced coal movements to Cholla (i.e., coal from non-McKinley mines) should be included in the revised SAC analysis. BNSF would not include such movements until 2007, or alternatively 2003. Arizona would include such movements as of 1997, when Arizona began obtaining coal from alternative mines. Under either party's approach, however, the updated evidence shows that the forecasts for this period proved somewhat optimistic, and the SAC analysis relied on in the *1998 Decision* overstated the extent that BNSF was overcharging Arizona during this period. As shown in *Table 1* below, even using Arizona's evidence, under the prior SAC analysis the total overcharges during the period 1994-2002 would have dropped by 14%, from $67.3 million to $57.8 million.

Table 1
Updated DCF Analysis
1994-2002
(millions of dollars)

	1998 Decision				Arizona's Reopening Evidence			
Year	Revenues (current)	SAC Costs (current)	Difference (current)	Difference ('94 dollars)	Revenues (current)	SAC Costs (current)	Difference (current)	Difference ('94 dollars)
1994	36.7	21.4	15.3	6.1	36.7	21.1	15.6	14.7
1995	30.2	18.5	11.7	9.8	28.5	16.3	12.2	4.1
1996	35.3	21.9	13.4	10.2	24.7	14.6	10.1	7.7
1997	35.6	22.7	12.9	8.7	31.2	19.7	11.5	7.7
1998	35.6	23.6	12	7.3	33.4	23.2	10.2	6.1
1999	35.6	26.6	9	4.9	32.2	25.5	6.7	3.6
2000	35.7	25.5	10.2	4.9	28.4	25.1	3.3	1.6
2001	35.7	26.6	9.1	4.0	38.6	30.6	8	3.5
2002	35.8	27.7	8.1	3.2	32.8	26.1	6.7	2.6
Total				67.3				57.8

For what is now the new forecast period, the updated evidence shows that the impending shutdown of McKinley has a profound impact on the prior SAC analysis. Revenues are now expected to drop precipitously in 2007, as the Cholla and Salt River plants begin to shift to other sources of coal in anticipation of the McKinley shutdown. By the end of 2008, all of the coal traffic to those two plants will come from other areas.

Both parties now project a significant under-recovery of costs for the remainder of the SAC analysis. As shown in *Table 2* below, according to Arizona's evidence, the cumulative revenues generated by the traffic group for the period 2003-2013 are now projected to fall $14.9 million (in 1994 dollars) below the revenue requirements of the SARR. This compares to a $6 million over-recovery forecast in the *1998 Decision*, or a difference of $21 million in net revenues for this time period. According to BNSF's evidence, the shortfall for this time period would exceed $20 million (in 1994 dollars). As discussed more fully below, we need not determine how large the shortfall might be. For purposes of this decision, what is significant is that both parties agree that there would be a substantial shortfall (at least $14.9 million).

Table 2
Updated DCF Analysis
2003-2013
(millions of dollars)

Year	1998 Decision				Arizona's Reopening Evidence			
	Revenues (current)	SAC Costs (current)	Difference (current)	Difference ('94 dollars)	Revenues (current)	SAC Costs (current)	Difference (current)	Difference ('94 dollars)
2003	35.9	28.8	7.1	$2.5	30.2	24.2	6	2.1
2004	36	30	6	$1.9	36.4	30.6	5.8	1.8
2005	36.2	33.8	2.4	$0.7	32.5	35.3	(2.8)	(0.8)
2006	36.3	32.5	3.8	$0.9	32.4	33.1	(0.7)	(0.2)
2007	36.4	33.9	2.5	$0.6	23.7	34	(10.3)	(2.3)
2008	36.6	35.3	1.3	$0.2	24.7	36.8	(12.1)	(2.4)
2009	36.9	36.8	0.1	$0.0	22.3	40.1	(17.8)	(3.2)
2010	37.9	38.4	(0.5)	($0.1)	22.6	40.7	(18.1)	(2.9)
2011	38.9	40.1	(1.2)	($0.2)	22.8	40.2	(17.4)	(2.5)
2012	40	41.8	(1.8)	($0.2)	23.8	41.9	(18.1)	(2.3)
2013	41.1	43.6	(2.5)	($0.3)	24	42.6	(18.6)	(2.1)
Total				$6.0				($14.9)

The Parties' Proposals to Address the New Shortfall

Ordinarily, when a SAC analysis shows a shortfall in later years, the SAC methodology used by the Board would redistribute that shortfall into years where there would be an over-recovery. *See 1997 Decision*, 2 S.T.B. at 393; *Texas Mun. Power Agency v. The Burlington N. & S. F. Ry. Co.*, 6 S.T.B. 573, 608-11 (2003). This permits the defendant railroad to charge more in the earlier years to offset the forecasted later shortfall. As the Board has explained, such "[n]etting is essential * * * because without it the railroad would have no means to recover the revenue shortfalls that would be incurred in certain periods." *1997 Decision*, 2 S.T.B. at 393. This netting procedure is also consistent with our purpose of simulating pricing in a contestable market, as the less optimistic the future looks, the higher the current rate would need to be to attract entry in a contestable market environment.

In this case, to address the shortfall created by the shutdown of McKinley, Arizona would have us make a proportional adjustment to raise the SARR's revenue requirements for the years between 1994-2004, as the Board has done when it initially decides a SAC case. This approach would allocate 95% of the post-2002 shortfall to the years 1994-2002, and it would change the rate prescription for the years 2003-2008 only modestly.

BNSF objects on the ground that this procedure would preclude it from recovering the full SAC costs identified for the 20-year analysis period.

Indeed, Arizona's approach, while showing a significant drop in the cumulative present value overage (revenues in excess of costs), would yield an even lower rate than initially prescribed for the post-2002 years. BNSF argues that Arizona's approach would frustrate the purpose of this reopening.

We agree that Arizona's approach is unacceptable here. It would shift most of the shortfall into years that are now beyond reach, so that the carrier would never be allowed to make up the shortfall. This would not comport with the objective of the netting procedure, which is to allow the railroad to charge higher rates in some years to offset shortfalls in other years.

BNSF would have us compare the rate prescribed in the *1998 Decision* with the rates it would have been entitled to collect if the impending shutdown of McKinley had been factored into the original SAC analysis. BNSF would then have us prescribe rates for the year 2003-2008 that would include a markup in a sufficient amount for the combined prescriptions for the two periods not to result in an under-recovery over the full 20-year SAC analysis period.

We lack the authority, however, to adopt BNSF's approach for two reasons. First, we cannot retroactively change a rate prescription, either directly, by ordering Arizona to pay reparations to BNSF for any prior miscalculation of the prescription, *see Arizona Grocery Co. v. Atchison, Topeka &S. F. Ry. Co.*, 284 U.S. 370, 389 (1932), or indirectly, by prescribing a rate for the future that is designed to compensate for any past over- or under-recovery. *See Associated Gas Distributors v. FERC*, 898 F.2d 809, 810 (D.C. Cir. 1990) (Williams, J., concurring); *Public Serv. Co. v. FERC*, 600 F.2d 944, 958 (D.C. Cir. 1979).

Second, BNSF's approach would have us set a maximum reasonable rate *above* the rate that was challenged in this proceeding. But our authority to prescribe a rate rests upon a Board finding that the challenged rate is unreasonable. *See* 49 U.S.C. 10704(a)(1). BNSF points out that the Board has prescribed rates for future years that exceeded the original level of a challenged rate. However, the Board has never prescribed a rate for any year that exceeded the challenged rate for that year, as determined by applying the appropriate escalation/deflation factor. *See, e.g., Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N.& S.F. Ry.*, 7 S.T.B. 626 (2004). Indeed, if we could set a maximum rate above the challenged rate, there would be no need for a netting procedure; if the SAC analysis showed a shortfall in a given year, we could offset that shortfall by raising the rate prescription above the challenged rate for that year. But the SAC analysis assumes that the defendant railroad would adhere to the rate that it has selected, adjusted by the appropriate index. In this case, applying the index selected by the carrier, the challenged rate would have been $4.76 per ton in 2003. Thus, we could not prescribe a rate of $7.21 for 2003, as BNSF has asked.

Appropriate Course of Action

The SAC analysis in the *1998 Decision*, updated as described above, does not support a rate prescription at any level. The updated SAC analysis does not reflect an over-recovery for the post-reopening period. In other words, according to the updated SAC analysis before us here, for what is now the forecast period (2003-2013), the challenged rates would fall below the levels needed to attract entry in a contestable market. However, we are not making any findings here as to the lawfulness of any rates from May 22, 2003 (the effective date of *2003 Reopening*) forward. Arizona contends that a full SAC analysis—one with an expanded traffic group—would show that the maximum lawful rate is below the old prescribed rate. Due to the limited nature of this reopening, the issue of the lawfulness of the rates from the date of this reopening has not been fully litigated. Therefore, we are simply vacating the prior rate prescription, which had been suspended in *2003 Reopening*. This restores rate control to BNSF, and permits Arizona to challenge the reasonableness of BNSF's chosen rate, using a redesigned SAC analysis of Arizona's choosing. On May 22, 2003, the Board suspended the (now-vacated) prescription and removed its prescriptive effect, entitling BNSF to collect its increased rate as of that date. A new complaint may therefore challenge BNSF's rate as of that date.

Pursuant to the keep-account provision of the *2003 Reopening*, Arizona should now compensate BNSF for the difference between the $6.91 rate BNSF had sought to charge and the $4.21 rate that Arizona has been paying, from May 22, 2003, to the effective date of this decision, together with interest. This proceeding is discontinued.

This decision will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The rate prescription imposed in the *1998 Decision* is vacated.
2. Pursuant to the keep-account requirement in *2003 Reopening*, Arizona shall compensate BNSF for the difference between the $6.91 rate BNSF sought to charge and the $4.21 rate held in place pursuant to the *2003 Reopening*, together with interest to be calculated in accordance with 49 *CFR* 1141, from the effective date of the *2003 Reopening* decision to the effective date of this decision.
3. This proceeding is dismissed.
4. This decision is effective January 12, 2005.

By the Board, Chairman Nober, Vice Chairman Mulvey, and Commissioner Buttrey.