MR. ROSENBERG: Good morning, and may it please the Board. I'm Robert Rosenberg of Slover and, Loftus, and it's my privilege to appear before you on behalf of the shipper in the proceeding, Arizona Electric Power Cooperative, Inc., or AEPCO. AEPCO's two highest ranking officers, it's Chief Executive

Officer, Don Kimball, and it's Chief Operating Officer, Mark Schwartz, have traveled from Arizona to be here for today's argument.

By way of background, AEPCO is a relatively small, consumer-owned, non-profit cooperative. It's coal burn at Apache Generating Station, it's coal fire facility, will not exceed 1.5 million tons in any year. At issue are shipments to Apache from -- to the New Mexico coal origins. Only BNSF serves the origins, and only UP serves Apache. AEPCO is thus a classic captive shipper.

Early on we, as was noted, challenged rates from other origins in Colorado and the Powder River Basin, but we were able to achieve a settlement with UP and, to simplify the case. The Board should understand that for a utility to buy coal from a particular coal origin, it needs to have a coal rate in place in order to transport that origin -- to transport that coal from the origin to the destination, and that's why early on we expanded the case to include those other origins. However, the New Mexico shipments remain important to AEPCO both now

and for the long-term future.

As noted, this case is four years old and it raises many issues. I'll address only some in my direct presentation. If you have questions about the other issues, as well as the matters that I address, I hope you will ask them.

The stand alone cost, or SAC issues, I'll address are trackage rights, divisions, a few individual capital and operating expenses, the cost of capital and productivity. The two variable cost issues I'll address are the South Western division and fuel.

To understand the stand-alone cost issues, particularly trackage rights, it's useful to consider a map of the stand-alone railroad system, if we could turn on the projection. Okay. And -- I'm sorry, which?

CHAIRMAN NOBER: Point it at the projector.

MR. ROSENBERG: Oh, point it at the projector. Okay. There we go. Thank you. That makes sense.

As you can see, the stand alone railroad, which in AEPCO's case has denominated the ACE, has two east/west segments that replicate transcontinental main lines of the Burlington Northern Santa Fe and the Union Pacific. These transcontinental main lines handle primarily non-coal traffic and the ACE serves primarily as a bridge, or overhead, carrier, for those movements, and over half of those movements consist of intermodal traffic.

In addition, ACE has a north/south leg running between Vaughn, New Mexico and El Paso, Texas, and the ACE utilizes BNSF's, existing trackage rights over UP for that segment. And one of the issues in the case is Defendants attack on ACE's use of those trackage rights.

The Board addressed AEPCO's use of trackage rights in its August 2002 decision. The Board there held that a SARR may replicate the existing cost-sharing arrangements, whether those trackage rights were voluntarily negotiated, or entered into pursuant to a merger. And the Board found that this guiding principal applied with equal

force to the BNSF, UP joint rates from the New Mexico origins.

We believe that that decision was compelled by the SAC principal that the SARR should not face any entry barriers. And, accordingly, we use those trackage rights because that is what a least cost most efficient entity would do. We also showed in our original rebuttal evidence that the trackage rights fee exceeded UP's system average attributable and unattributable below the costs.

In the November 2003 decision, the Board upheld AEPCO's use of trackage rights, but said the defendants should be allowed to show the level at which a usage fee would need to be set to satisfy the objectives of the SAC test. Again, we don't think that allowing a higher fee is correct, as it imposes an entry barrier. We also don't think that the Board's distinction, based on the presence of a joint rate, is in any sense meaningful.

The cost charged by a least cost most efficient competitor shouldn't vary according to whether Defendants choose to utilize a joint through

rate, or some other arrangement to provide this service. Beyond that, the Defendant's position appears to be that AEPCO must submit a full SAC build-out for the segment, but the Board's November 2003 decision plainly held otherwise.

Regardless, Defendants failed to show or even attempt to show, what the higher fee should apply. Instead, they actually used the same trackage rights fee that we did throughout our evidence. Under the circumstances, the fee that AEPCO utilized is the best and, indeed, the only evidence of record, and should be utilized.

Another major stand alone cost issue in this case involves the divisions on the ACE's cross-over non-coal traffic, over half of which is intermodal. Defendants devoted substantial effort in their supplemental reply filing to claiming an enhanced division. We demonstrated in our supplemental rebuttal that their evidence and calculations are entirely deficient. I think it makes sense for me to address those defects, only after they today have explained what their approach and their

current clarifications are. For now, I want to explain what we did, which was to use the standard approach that the Board had in effect at the time.

When we submitted our original evidence, the Board's standard approach was modified mileage block prorate, or MMP, and that's what we utilized in our evidence. At the time of our supplemental rebuttal, the Board had switched to modified straight mileage prorate, or MSP, and so we utilized that.

We did show that MMP correlated well with the carriers commercial divisions on overhead traffic. We also showed that MMP did not significantly reduce the Defendant's revenue to variable cost, or ratios on the cross-over movements, handling them as residual incumbents, compared to their handling the full movements without the insertion of the ACE as a bridge carrier. With MSP the impact is even less, because MSP serves to reduce the ACE's Division.

Defendants introduced the analysis with their original reply. We think the analysis is very instructive, because it reflects that the fact that the stand-alone railroad handles only a small portion

of the total line haul, and the residual incumbents retained not only the terminal activities, but also the vast bulk of the line haul movement. We believe this is a more meaningful and, certainly, a more stable analysis than the terminal to line haul comparison that they later introduced in their supplemental reply.

I also want to respond to Defendant's claim that the intermodal traffic is somehow too marginal to support a stand-alone railroad. The claim just doesn't wash. The railroads don't act as if the traffic is marginal in terms of their pursuit of it, or their investment in it.

At the transportation forum held in this room just a few weeks ago, we heard Wall Street representatives say that intermodal covers its cost of capital, notwithstanding it's high operating ratio, which I think they put in the 90 percent range. Wall Street would not be saying that, if they hadn't been persuaded by the railroads of its truth. And traffic that covers its cost of capital for the real world incumbents should certainly be able to support a

least cost, most efficient stand-alone railroad.

This case also presents a myriad of individuals stand alone cost operating capital expense issues. I want to briefly touch on just a few of them. For fueling arrangements, Defendants claimed that ACE must pay the residual BNSF to haul fuel from Belen to Vaughn, where the ACE fuels some of its locomotives, because no pipeline currently serves Vaughn. But the stand alone cost theory says that the stand-alone railroad should have the same access to resources and services as the incumbents. We also show that there's a pipeline, a petroleum products pipeline, that comes within 30 miles of Vaughn, and that the cost of building out and operating a pipeline extension from that point to Vaughn, is such that the ACE would be able to receive fuel at a delivered cost less than the BNSF system average price that we utilized in our analysis. Defendant's attack is thus deficient in both theory and fact.

For locomotive fuel consumption, Defendant's simply rigged their train performance simulator by assuming the least fuel efficient

throttle settings possible. Their assumptions as to throttle settings don't correlate either to -- either to the real world operations they otherwise purport to rely upon, or to AEPCO's posited operations. Consequently, their fuel consumption analysis cannot be accepted.

AEPCO did utilize the String Program to calculate certain operating expenses, primarily train crews and locomotives counts. While similar programs have been rejected in other recent cases by the Board, we submit that the String Program should still be accepted here for several reasons.

First, the ACE handles the same trains as Defendants, over much the same route and facilities. Thus, the questions of basic feasibility that have been raised in other cases are not present here. In fact, the ACE actually has expanded capacity compared to the incumbents and, at the same time, it actually handles less traffic. In particular, the ACE eliminates some disruptive local trains of both Defendants, and it also eliminates disruptive Amtrack trains that both Defendants handle.

Defendants introduced no modeling of the operations of their own, but they simply assume that their historic transit times would apply. That is not a realistic assumption, given that stand-alone railroad has both greater capacity, and uses that greater capacity to handle less traffic. Some improvement in transit times is inevitable, and only AEPCO introduced an analysis of it.

Defendants did present specific criticisms that related primarily to the use of average input values in the String program for things like number of locomotives and car weights. On supplemental rebuttal, we showed that the average values that we utilized were conservative and/or if we switched to using the actual input values from individual trains, the results of the String Program Analysis did not change significantly.

Defendants also raise the disappearing train criticism that was noted in Pawnee. First of all, we don't believe that this is a valid criticism at all. Instead, it's just a conservative way to reconcile a faster transit times with historic loading

times in the theoretical construct.

In the real world, the faster transit times would enable the same volume of coal to be handled with fewer train sets, and that would confer additional benefits on the system and on the shippers. Furthermore, only four percent of the ACE's trains serve local origins, and the ACE has ample unused sidings to be able to store the trains, or to hold them, if that's what's actually required. So, even if the criticism -- the disappearing train criticism -- has some general validity, it's simply not applicable to the ACE's particular circumstances.

For maintenance-of-way, our approach to cross-train staffing in -- outside the contracting, it is reasonable and entirely consistent with what is used by short line railroads in both Canada and the United States. It is especially consistent with the currently pending proposal of the Buckingham branch in Finance Docket Number 34495, to operate and, more importantly, maintain CSXT's 200-mile line between Richmond and Clifton Forage, Virginia.

CSXT has obviously found that maintenance

away approach to be acceptable as evidenced by its entering into the arrangement and, if a maintenance away approach is acceptable for a Class I railroad, it should certainly be acceptable for a least cost, most efficient entity. At the very least, the maintenance away staffing for the full stand-alone railroad should reflect the UP's level of staffing, rather than the higher level of staffing on BNSF's part of the stand-alone railroad, least cost, most efficient principals.

We also raised two issues on the discounted cash flow, or DCF model. They relate to the cost of capital and productivity. For cost of capital -- And if I can put up another slide, here -- our point is simply that you can't combine a recent low inflation forecast with the dated high cost of capital. This chart here shows what's been happening to the cost of capital, particularly the cost of debt, in the period since the -- I guess in the period -- the period covered by the case so far, the years 1998 to 200 -- as in 1998 to 2000 -- represent the construction period, and then 2001 to 2003 represent the historical years of actual performance. And, as

you can see, the cost of capital has gone down in that period and, in particular, the cost of debt has gone down significantly. Between 2000 and 2003, the decrease from 8 percent to 5 percent corresponds to a 37.5 percent decrease.

The base case analysis, column five there, represents the -- I guess our base case and our supplemental rebuttal, to which Defendants stipulated at our most recent technical conference, although I would note that the 2003 values are new. They didn't exist at the time that we -- we had the technical conference and represented our calculations. But it actually shows that the 2003 cost of equity under the base analysis would be higher than what it was in 2002, even though the cost of capital went down, and the cost of debt went down from 6 percent to 5 percent, or about a -- almost a 17 percent decline.

The result of the Defendants approach is to impose a real cost of capital that is higher than that that confronts the incumbents in the real world, and that constitutes an impermissible entry barrier. It is also inconsistent with the holding in West Texas

Utilities that a stand-alone railroad should be able to refinance its debt at lower interest rates. It is further inconsistent with the Board's switch to facing inflation on a recent forecast, rather than a four-or five-year average of historic values. The Board should use a cost of capital that is consistent with its inflation forecast. Above all, the Board should not engage in selective updating of DCF inputs.

Regarding productivity, it should be kept in mind that the ACE serves almost exclusively as a bridge carrier. As such, it handles the trains that the residual incumbents provide to them. As the residual incumbents are able to originate longer and heavier trains, those productivity benefits will automatically inure to the ACE. Moreover, the ACE, as a least cost, more efficient entity, will be able to avoid at least some of the problems that confront real world railroads and serve to drag down industry average productivity. Examples include disruptive rail mergers, and the current train crew problems that currently afflict Union Pacific. The stand-alone railroad won't have these problems and, thus, it has

reasonable prospects for exceeding the industry average productivity.

Moreover, the RCFU reflects the cost of obtaining inputs that are more expensive because they are more productive. A primary example would include fuel efficient -- locomotives that are more fuel efficient. If a stand-alone railroad is going to be stuck with the cost of -- with the higher cost of these inputs, then it should be able to receive the associated productivity benefits.

In past cases the Board has stressed the newness of the stand-alone railroads assets as a reason not to apply the RCFA. We don't think that that is or should be a decisive factor, especially, as we showed, that the difference in ages between the assets of the stand-along railroad and then the real world incumbents is not all that significant. Moreover, the stand-alone railroad here uses the same basic technology as the defendants; however, if you do feel that the age of the assets is such a decisive factor, the proper approach is not to discard the RCFA all together but, instead, to phase it in over a

period of time, corresponding to the difference in the average asset age, which we showed was no more than four to six years.

I'll now turn to the variable cost issues. I'd also note that we devoted half of our brief to these variable cost issues, whereas Defendant ignored them entirely. Again, it's useful to consider a map, which we have projected up there. It shows that the BNSF serves the two origins at McKenley and Lee Ranch, and then moves the -- moves the coal trains through Belen and then south through Rincon to Deming, which is the interchange point with UP, and then UP effectuates the delivery to the Apache generating station, which is located near Cochise.

Starting the fourth quarter of 2001, the South Western Railroad began handling the 54.3 mile segment between Rincon and Deming. Treatment of South Western's division constitutes the single largest variable cost issue. We believe that the division should be treated as what it is, and that is a division, in which case it is recouped as an offset against revenues, but without any mark-up. Defendants

contend that it should be treated as a cost of service, and thus marked up by 80 percent.

In our view, only the division treatment is appropriate. The underlying agreement calls it a division, it covers 14 percent of the total line haul. The underlying agreement was entered into after AEPCO's rate case began when the complaint was filed on December 29th 2000, and the line haul charge and line haul division can't be properly analogized to a handling -- switching charge that is set by an independent carrier.

There is every reason to think that the South Western's division includes a profit component that the South Western finds to be acceptable. Otherwise, there would be no reason for the South Western to have entered into the agreement. The variable cost treatment posited by Defendants would give them a profit on the South Western's profit.

Such a recovery has nothing to do with cost recovery or rational or regulatory costing. Furthermore, it creates a perverse incentive for BNSF to pay the South Western Railroad more so that the

Defendants can ultimately receive a greater absolute dollar mark-up.

There are related issues that involve additional operating or capital costs that BNSF claims for the operations over the Rincon-Deming segment. We showed that these costs are subsumed within the lease, as the lease limits South Western's use of the relevant assets, and further provides that South Western is responsible for the cost.

We further submitted evidence that is summarized in a slide here, and I've redacted the actual numbers. This is taken from our reply evidence, but I've -- you know, I've used dummy variables, A, B, C and D, so as not to disclose the South Western division, which is confidential.

But what we did in this analysis, is we utilized BNSF's costing for the Rincon segment. Both the division and the other are disputed items. And -- A, was -- you know, the cost treatment used by the Defendants. B, is what the costing would be if -- for this quarter, which is the fourth quarter of 2001, the first quarter that South Western was involved, and we

showed that C was a positive number, and that D represented an 80 percent mark-up of C.

And our point here was to show that this arrangement that was ostensibly entered into to reduce costs and to increase efficiency, actually serves with defendant's costing to increase the variable cost, and to increase the jurisdictional threshold even more. And this is not what should happen under either an arrangement that's designed to save costs, or a rational costing system.

The last variable cost issue I want to address is fuel. We have relied on a fuel study from AEPCO's earlier rate case, not to show the absolute level of fuel consumption but, instead, to show the relationship of consumption of AEPCO's trains to the system average.

Notwithstanding the age of the study, the relationship between coal trains and system average still holds. Since the time of AEPCO's study, locomotives have become more fuel efficient, and the same locomotive technology is used on both coal and non-coal trains. The difference, however, then and

now, is that coal trains are powered for efficiency; whereas, non-coal trains are powered for speed.

As Defendant's noted in their supplemental reply at -- I believe it was at page III-D-9 3D9, this was especially true of the intermodal trains that constitute a larger part of the total traffic mix. Accordingly, the earlier fuel study, logically, understates the current relationship for fuel consumption. Moreover, Defendant's did not submit any fuel study of their own, despite obviously being in a position to do so. Under the circumstances, AEPCO's fuel study constitutes the best evidence of record, and should be utilized.

I thank you for listening to me. Hopefully, I have a little unused time from what was previously allocated, and I'd be glad to answer any questions you might have.