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October 25, 2004

Via HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

Re: ***Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad Company***
STB Docket No. 42058

Dear Secretary Williams:

Pursuant to the Board's decision served on October 7, 2004, the defendants The Burlington Northern and Santa Fe Railway Company ("BNSF") and Union Pacific Railroad Company ("UP") submit an original and 10 copies of their joint summary of oral argument discussion points that they propose to address during the oral argument in this matter that the Board has scheduled for November 2, 2004.

Oral argument will be divided between the undersigned on behalf of BNSF and David L. Meyer on behalf of UP.

Sincerely,

Samuel M. Sipe, Jr.

Enclosures

cc: Robert D. Rosenberg (w/enc)

DEFENDANTS' SUMMARY OF ORAL ARGUMENT DISCUSSION POINTS IN DOCKET NO. 42058

This case involves the transportation of coal from two mines in northern New Mexico to the complainant's coal-fired electric generating station in southern Arizona, the Apache Station. BNSF originates the issue traffic and UP delivers it. Transportation is provided in unit coal trains using cars supplied by the complainant, AEPCO.

AEPCO has challenged the reasonableness of the joint rate established by BNSF and UP for the issue traffic service under the SAC test. At oral argument defendants intend to address four principal issues.

AEPCO's Reliance on Trackage Rights Over UP's Vaughn-El Paso Line: AEPCO's SAC presentation is fundamentally flawed due to AEPCO's continued reliance on a SARR configuration that uses trackage rights between "joint-rate defendants" for nearly one-third of its route miles – the segment between Vaughn and El Paso. In the real world AEPCO's coal moves via a much shorter route over a low density line between Belen and Deming, New Mexico. The Board's November 2003 decision ruled that AEPCO's proposed configuration "defeat[s] the SAC test" and is thus impermissible. The Board also observed that there was "good cause to believe that the existing usage fee would not be adequate to reflect the full SAC costs of providing service over the Vaughn-to-El Paso line segment." The Board nevertheless (and erroneously, defendants believe) offered AEPCO another opportunity to present evidence demonstrating that its SARR configuration satisfies the objectives of the SAC test. AEPCO has not done so.

In accord with the Board's November 2003 decision, defendants demonstrated that the trackage rights fee is not sufficient to cover the full SAC costs of the Vaughn-El Paso line. Defendants have also shown that no such fee could substitute for presentation of SAC evidence that includes matters such as the costs of building the line; the SARR's other traffic, if any, on the line; the appropriate allocation of revenue from that traffic; and the SARR's costs of handling that traffic. AEPCO did not respond to defendants' showing by submitting any evidence addressing the SAC costs of this portion of ACE's network. Instead, it relies solely on the fact that the existing trackage rights fee is similar to the fee approved in the *UP/SP* merger case. But the analysis in that case did not purport to address the host of issues that must be considered in order to determine whether revenues provide for full SAC cost recovery.

Allocation of Revenues on Cross-Over Traffic: AEPCO's proposed revenue allocations on cross-over traffic are arbitrary and vastly excessive. Ninety-eight percent of the SARR traffic is cross-over traffic and the majority of that traffic consists of intermodal and automotive traffic that is exempt from rate regulation because it faces pervasive competition that restrains rates. However, AEPCO's revenue allocations assign so much revenue to cross-over traffic moving over the SARR that the SAC revenues from this exempt traffic alone exceed the SAC costs for the entire SARR, suggesting implausibly that defendants are earning monopoly profits on exempt traffic. The Board cannot accept an allocation methodology that produces such nonsensical results.

AEPCO's failure to present a plausible revenue allocation methodology should result in dismissal of AEPCO's complaint without further analysis of the parties' SAC calculations. However, if the Board does address the merits of the parties' SAC calculations, it should use defendants' cost-based evidence on the allocation of cross-over revenues. Defendants used a modified form of the Board's MSP methodology that takes account of the relative on-SARR and off-SARR costs of the intermodal, automotive and manifest traffic handled by the SARR. Rather than using the MSP methodology's 100-mile origination and termination credit, which substantially understates the costs to originate and terminate intermodal, automotive and manifest traffic, defendants developed a more precise ratio of origination and termination costs to line-haul costs for each traffic group. Defendants' modified MSP evidence is the best evidence in this case on the allocation of revenues on cross-over traffic.

AEPCO's Flawed Operating Plan and Operating Expense Evidence: In several important respects AEPCO's assumptions concerning the SARR's operations are neither feasible nor verifiable and must be rejected. For example, AEPCO's operating statistics are generated by a string program that is inherently unreliable and subject to manipulation. The Board has rejected similar string program analyses in past cases. AEPCO's fuel cost calculations ignore the cost of delivering fuel to SARR fueling facilities that AEPCO chose to locate where there is no existing supply of fuel. AEPCO cannot avoid responsibility for these costs by assuming that a fantasy pipeline will spring into existence when the SARR is built. AEPCO's MOW plan is virtually indistinguishable from MOW plans that the Board has previously rejected as inadequate for a heavy-haul, high-tonnage railroad such as the SARR posited by AEPCO in this case.

Variable Costs: Defendants intend to address one variable cost issue that was discussed at length in AEPCO's final brief – the proper treatment of BNSF's car handling payments to the Southwestern Railroad ("SWRR"). AEPCO urges the Board to consider the SWRR as a common carrier participating in the movement and therefore to treat BNSF's payments to SWRR as a revenue division rather than a cost. But the SWRR is not a party to the common carrier pricing authority at issue in this case. BNSF and the UP are the carriers responsible for transporting the issue traffic. The case law makes clear that under these circumstances the fee paid to SWRR is a cost to be included in the defendants' variable costs, not a revenue division.