

SOAH DOCKET NO. 473-06-2536  
PUC DOCKET NO. 32766

APPLICATION OF SOUTHWESTERN §  
PUBLIC SERVICE COMPANY FOR: §  
(1) AUTHORITY TO CHANGE § BEFORE THE STATE OFFICE  
RATES; (2) RECONCILIATION OF §  
ITS FUEL COSTS FOR 2004 AND §  
2005; (3) AUTHORITY TO REVISE § OF  
THE SEMI-ANNUAL FORMULAE §  
ORIGINALLY APPROVED IN §  
DOCKET NO. 27751 USED TO § ADMINISTRATIVE HEARINGS  
ADJUST ITS FUEL FACTORS; AND §  
(4) RELATED RELIEF §

REBUTTAL TESTIMONY  
*of*  
THOMAS D. CROWLEY  
*on behalf of*  
SOUTHWESTERN PUBLIC SERVICE COMPANY  
*(Fuel Reconciliation)*

(Filename: 7M8.pdf; Total Pages: 97)

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## **Glossary of Acronyms and Defined Terms**

<b><u>Acronym/Defined Term</u></b>	<b><u>Meaning</u></b>
Arch	Arch Coal Sales Company, Inc.
Amended and Restated Agreement	Amended and Restated Coal Supply Agreement between Thunder Basin Coal Company, L.L.C., Arch and TUCO effective July 1, 2001
Arch Settlement Agreement	2003 Coal Supply Agreement between TUCO and ARCH
Arch 2001 CSA	Arch 2001 Coal Supply Agreement between TUCO and Arch
AXM	Alliance of Xcel Municipalities
BNSF	BNSF Railway Company
Btu	British Thermal Unit
Buckskin Spot Contract	Spot Coal Contract between TUCO and Buckskin Mining Company
Dairyland Spot Contract	Spot Contract between TUCO and Dairyland Power Cooperative
Data Sheet	Contract Data Sheet Prepared for the Tolk Generating Station Prepared by Combustion Engineering, Inc.
EFE	Eligible Fuel Expense
GSU	Entergy Gulf States, Inc.
Harrington	Harrington Generating Station
ICC	Interstate Commerce Commission
Joint Line	The UP/BNSF Joint Rail Line Serving the PRB
OPC	The Office of Public Utility Counsel

Peabody Coal Trade CSA	Coal Sales Agreement between TUCO and Peabody Coal Trade, Inc. effective January 1, 2002
PRB	Powder River Basin
PUCT	Public Utility Commission of Texas
Reconciliation Period	The period January 1, 2004 to December 31, 2005
RFP	Request for Proposal
Settlement and Release Agreement	2006 Settlement and Release Agreement between TUCO and Arch
SPS	Southwestern Public Service Company
STB	Surface Transportation Board
TIEC	Texas Industrial Energy Consumers
Tolk	Tolk Generating Station
TUCO	TUCO Inc.
TUEC	Texas Utilities Electric Company
UP	Union Pacific Railroad Company
WPSC	Wyoming Public Service Commission
Xcel Energy	Xcel Energy, Inc.

## List of Attachments

<u>Attachment</u>	<u>Description</u>
TDC-R1	Statement of Qualifications (Filename: TDC-R1.doc)
TDC-R2	Graph of PRB 8,800 Btu Coal Prices – 1Q96 through 4Q06 (Filename: TDC-R2.xls)
TDC-R3(CONF)	The Net Present Value of Schwartz's Costs of the Settlement and Release Agreement (Filename: TDC-R3(CONF).xls)
TDC-R4(CONF)	The Present Value of Derating Costs – 2006 to 2010 (Filename: TDC-R4(CONF).xls)
TDC-R5	Utilities Using Powder River Basin Coal Reporting Service Problems (Filename: TDC-R5.xls)

**REBUTTAL TESTIMONY  
OF THOMAS D. CROWLEY**

1                   **I.       INTRODUCTION AND QUALIFICATIONS**

2  
3   **Q.       PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

4   A.       My name is Thomas D. Crowley. My business address is 1501 Duke Street, Suite  
5            200, Alexandria, VA 22314-3449.

6   **Q.       BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?**

7   A.       I am an economist and President of L. E. Peabody & Associates, Inc., an  
8            economic consulting firm that specializes in fuel procurement, fuel management  
9            and fuel transportation matters.

10   **Q.       ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

11   A.       I am testifying on behalf of Southwestern Public Service Company (“SPS”).

12   **Q.       PLEASE BRIEFLY OUTLINE YOUR RESPONSIBILITIES AS**  
13            **PRESIDENT OF L. E. PEABODY & ASSOCIATES, INC.**

14   A.       As an economist and the President of L. E. Peabody & Associates, Inc., I am  
15            responsible for advising clients, including electric utility companies, on a wide  
16            variety of issues, including economic, marketing, transportation, fuel supply and  
17            fuel management.

18   **Q.       PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

19   A.       I received a Bachelor of Science degree in Economics from the University of  
20            Maine. I have also taken graduate courses in transportation at George  
21            Washington University in Washington DC.

1 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

2 A. As an economic consultant, I have organized and directed economic studies and  
3 prepared reports for railroads, freight forwarders and other carriers, for shippers,  
4 for associations and for state governments and other public bodies dealing with  
5 transportation and related economic problems.

6 I have been involved in the negotiation of over 100 coal transportation  
7 agreements, as well as provided consultation relating to the administration of  
8 economic, operational, and logistical aspects of these agreements. In the course  
9 of performing these duties, I have obtained an intimate familiarity with the major  
10 western railroads, The BNSF Railway Company (“BNSF”) and Union Pacific  
11 Railroad Company (“UP”). This familiarity includes detailed knowledge of  
12 railroad operations in the principal coal supply regions they serve, including the  
13 Powder River Basin (“PRB”) coal fields located in Campbell and Converse  
14 Counties, Wyoming.

15 I have also been actively engaged in negotiating coal supply contracts for  
16 various users throughout the United States. These negotiations have related to  
17 both long-term and short-term contracts. I also have been involved in both the  
18 design and implementation of price reopener provisions in coal supply contracts.  
19 In addition, I have analyzed the economic impact of buying out, brokering, and  
20 modifying existing coal supply agreements. My coal supply assignments have  
21 encompassed analyzing alternative coals to determine the impact on the delivered

1 price of operating and maintenance costs, unloading costs, shrinkage factor and  
2 by-product savings.

3 I have also developed different economic analyses for over sixty (60)  
4 electric utility companies located in all parts of the United States, and for major  
5 associations, including American Paper Institute, American Petroleum Institute,  
6 Chemical Manufacturers Association, Coal Exporters Association, Edison  
7 Electric Institute, Mail Order Association of America, National Coal Association,  
8 National Industrial Transportation League, the Fertilizer Institute and Western  
9 Coal Traffic League. In addition, I have assisted numerous government agencies,  
10 major industries and major railroad companies in solving various economic  
11 problems.

12 A complete statement of my qualifications is included as Attachment  
13 TDC-R1.

14 **Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS**  
15 **RELATED TO YOUR AREA OF TESTIMONY?**

16 A. I am a member of the American Economic Association, the Transportation  
17 Research Forum and the American Railway Engineering and Maintenance-of-  
18 Way Association.

19 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY AT ANY**  
20 **REGULATORY COMMISSION?**

21 A. Yes. I have presented evidence before the Interstate Commerce Commission  
22 (“ICC”) in a number of proceedings including Ex Parte No. 347 (Sub-No. 1),

1           *Coal Rate Guidelines - Nationwide* which is the proceeding that established the  
2 methodology for developing a maximum rail rate. I have submitted evidence  
3 applying the ICC's maximum rate procedures in every proceeding before the ICC  
4 and its successor, the Surface Transportation Board ("STB"). I have frequently  
5 presented both oral and written testimony before the Interstate Commerce  
6 Commission, Surface Transportation Board, Federal Energy Regulatory  
7 Commission, Railroad Accounting Principles Board, Postal Rate Commission and  
8 numerous state regulatory commissions, federal courts and state courts as well as  
9 arbitration proceedings. I presented testimony before the Congress of the United  
10 States, Committee on Transportation and Infrastructure on the status of rail  
11 competition in the western United States.



1 **II. ASSIGNMENT**

2  
3 **Q. WHAT IS YOUR ASSIGNMENT IN THIS PROCEEDING?**

4 A. I have been requested by SPS to address certain issues raised in the direct  
5 testimonies of Alliance of Xcel Municipalities’ (“AXM”) witness, Seth Schwartz,  
6 Texas Industrial Energy Consumers’ (“TIEC”) witness, Kevin B. Cardwell, the  
7 Office of Public Utility Counsel’s (“OPC”) witness, Randall J. Falkenberg and the  
8 Public Utility Commission of Texas’s witness T. Brian Almon. Specifically, I  
9 will: (a) respond to Mr. Schwartz’s claims that SPS did not prudently manage its  
10 coal purchases during the period January 1, 2004 to December 31, 2005  
11 (“reconciliation period”); (b) respond to Mr. Schwartz’s claim that the inventory  
12 target at Tolk and Harrington should be increased; (c) respond to the claims of  
13 Mr. Cardwell, Mr. Falkenberg and Mr. Almon that SPS was imprudent in  
14 instituting coal mitigation at Tolk and Harrington in late June, July and early  
15 August, 2005, and that the cost of the mitigation should be disallowed as part of  
16 the fuel reconciliation proceeding.

17 **Q. WHAT RECORD MATERIALS HAVE YOU REVIEWED?**

18 A. I have reviewed the direct testimony of Patrick J. Panzarino; the direct testimony  
19 of Messrs. Schwartz, Cardwell, Falkenberg and Almon; the exhibits to the direct  
20 testimonies of the witnesses; and pertinent materials produced in discovery in this  
21 proceeding.

1 **Q. WHAT IS THE BASIS FOR YOUR EXPERT OPINIONS?**

2 A. My expert opinions are based on my review of pertinent record materials, my  
3 familiarity with the rail service disruption that began in 2005, my prior  
4 involvement in a contract dispute between Tuco, Inc. (“TUCO”) and Arch, the  
5 other materials cited in my testimony and my 36 years of experience with fuel  
6 procurement, fuel management and fuel transportation matters.

7 **Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS.**

8 A. Following my review of the Direct Testimony of Messrs. Schwartz, Cardwell,  
9 Falkenberg and Almon, of various discovery responses and documents furnished  
10 by SPS in this Docket and of publicly available data, I have come to the following  
11 conclusions:

- 12
- 13 1. SPS acted prudently when it implemented a coal conservation program in  
14 the summer of 2005 due to rail service disruptions brought about by  
15 maintenance problems to the jointly owned rail line in the PRB, WY.  
16
  - 17 2. I believe that SPS/TUCO’s negotiations of the various coal supply  
18 agreements for Harrington and Tolk were prudent given the provisions of  
19 the then existing coal supply agreements, the scope and scale of SPS’s  
20 generating operations and the state of the coal supply and coal  
21 transportation markets at the time of the negotiations.  
22
  - 23 3. Mr. Schwartz’s claim that TUCO changed the contractual language in its  
24 coal supply agreements to allow for the shipment of substitute coal and to  
25 incorporate new coal characteristics is incorrect. The contract terms that  
26 Mr. Schwartz identified as “new” had in fact been in place since 1985.  
27
  - 28 4. Mr. Schwartz is incorrect in stating that the Standstill Agreement  
29 payments SPS/TUCO made to Arch to halt the shift of low Btu coal were  
30 imprudent. Mr. Schwartz based his imprudence argument on faulty  
31 assumptions about the ability of SPS/TUCO to resell coal and on an  
32 incomplete analysis of the benefit of the Standstill Agreement payments to  
33 Arch. Also, Mr. Schwartz’s analysis failed to take into consideration the

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costs of derating Tolk and Harrington if SPS/TUCO had accepted the low Btu coal. When costs of derating the plants are accounted for, it becomes readily apparent that SPS/TUCO's actions on the Standstill Agreement payments are prudent.

- 5. Mr. Schwartz's claim that SPS/TUCO was imprudent in negotiating the Settlement and Release Agreement due to the Agreement's excessive costs is also incorrect. Mr. Schwartz's arguments are based on speculative forecasts that directly impact his cost estimates. Moreover, Mr. Schwartz failed to quantify the benefits of the Settlement and Release Agreement to SPS/TUCO. The benefits of the Settlement and Release Agreement more than outweigh the costs, showing that SPS/TUCO acted prudently.
  
- 6. Mr. Schwartz's claim that SPS's analysis of the Settlement and Release Agreement was too conservative is also without merit. SPS's analysis was consistent with the design parameters of the SPS generating stations, and took into consideration available capacity and future generation needs. In addition, Mr. Schwartz's claim that other Texas utilities use low Btu coal, and therefore, SPS should have taken into consideration modifications to its generating stations ignores the fact that power plants are not fungible assets.
  
- 7. Mr. Schwartz's assertion that the 2006 price reopener of the Amended and Restated Agreement was imprudent is likewise incorrect. Mr. Schwartz based his claim on an intermediate comparison between Arch's proposed price and prices received from other coal providers that took into consideration only mine costs. When other costs and benefits are taken into consideration, including the cost of derating the SPS generating stations, it becomes evident that SPS selected the best available offer, and was therefore prudent in its actions.
  
- 8. Mr. Schwartz's contention that the target inventory levels at Tolk and Harrington are too low, and SPS should have rectified this problem prior to the rail service disruption ignores the fact that SPS attempted to raise its target inventory levels in Docket No. 29801, but withdrew its request when PUCT staff opposed it.
  
- 9. Mr. Cardwell's assertion that SPS/TUCO would not have begun coal conservation in the summer of 2005 if it had an accurate measure of inventory ignores the expected magnitude of the disruption and a SPS analysis that shows even at the higher actual inventory levels, SPS would still have had to implement coal conservation measures.

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10. Mr. Cardwell's claims regarding changes in inventory levels at the SPS plants and the Buckskin and Dairyland short-term coal supply agreements support his position that SPS acted imprudently are ill-founded, and are based on effects leading the cause of the action and not causes leading to effects.
  11. I believe that Mr. Cardwell's assessment that SPS/TUCO could have waited longer to initiate coal conservation measures is a classic example of "Monday Morning Quarterbacking." Given the information that was available at the time, a reasonable assessment of likely future events and the requirement to provide service to its customers, I believe SPS acted prudently in initiating its coal conservation program.
  12. Mr. Falkenberg's assertion that SPS is responsible for \$7.6 million on a Texas jurisdictional basis in additional fuel expense because of the imprudent actions by SPS and/or its third party suppliers is erroneous. Mr. Falkenberg's assertion is based on the faulty premises that utilities have complete control over their suppliers, while maintaining the ability to economically generate power. In addition, the prior case precedents cited by Mr. Falkenberg do not support his assertion of third-party imprudence in this case.
  13. Mr. Almon's contentions that SPS/TUCO did not realize in 2004 that coal deliveries were not at a level that maintained the target inventory at each plant, and that SPS/TUCO did not take actions with the BNSF to assist in resolving the coal delivery problems are incorrect. SPS provided discovery that showed that SPS/TUCO understood that BNSF's longer cycle was a primary factor in the lower than target level inventories, and that SPS/TUCO took proactive actions with BNSF to resolve the problem.
  14. Mr. Almon's claim that SPS/TUCO should have more closely considered the timing of its physical inventories to have the most up to date information available at the beginning of the service disruption is nothing but a red herring. Even if SPS had known its actual physical inventory at the beginning of the BNSF's service disruptions, I believe it still would have been prudent to initiate the coal conservation program.
  15. Mr. Almon's assertion that SPS/TUCO should have accepted all of its 2005 spot coal purchases fails to recognize that, given SPS/TUCO's availability of transportation equipment, SPS/TUCO could not have transported both its spot coal purchases and its coal moved under the Arch contracts. I believe that SPS/TUCO took the prudent action of transporting the higher Btu coal available under its Arch contracts instead of the lower Btu spot coal.

1                   **III. PRUDENCE OF SPS'S NEGOTIATIONS WITH ARCH**

2  
3   **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE**  
4   **RELATIONSHIP BETWEEN SPS AND TUCO.**

5   A. SPS owns and operates two coal-fired power plants: Harrington Station and Tolk  
6   Station. TUCO has two long-term contracts with SPS to supply the coal  
7   requirements at Tolk and Harrington. These contracts call for TUCO to provide  
8   specified services to SPS including making arrangements for the purchase and  
9   transportation of coal to both stations. As described in detail in Mr. Panzarino's  
10   Direct Testimony, SPS, and its parent Xcel Energy Inc. ("Xcel Energy"), work  
11   closely with TUCO to insure that TUCO's contracts with coal suppliers, and its  
12   contracts with rail service providers are reasonable.

13   **Q. HAVE YOU REVIEWED THE VARIOUS COAL SUPPLY AND**  
14   **ANCILLARY AGREEMENTS TUCO NEGOTIATED WITH ARCH FOR**  
15   **COAL SUPPLY TO SPS'S TOLK AND HARRINGTON STATIONS?**

16   A. Yes, I have reviewed the original coal supply agreements and all of the associated  
17   amendments, including the 2003 Coal Supply Agreement between TUCO and  
18   Arch ("Arch Settlement Agreement"), the Amended and Restated Coal Supply  
19   Agreement between Thunder Basin Coal Company, L.L.C., Arch, and TUCO  
20   ("Amended and Restated Agreement") and the 2001 Coal Supply Agreement  
21   between TUCO and Arch ("Arch 2001 CSA"). I have also reviewed the standstill  
22   agreements between TUCO and Arch which limited the delivery of low-rated Btu  
23   coal to Tolk and Harrington for various periods between March, 2005 and

1 February, 2006, and the 2006 Settlement and Release Agreement which settled  
2 and released all of the claims and disputes between Arch and SPS/TUCO  
3 regarding substitute fuel and other issues between the parties (“Settlement and  
4 Release Agreement”). I have also reviewed the two spot contracts between  
5 TUCO and Buckskin Mining Company (“Buckskin Spot Contract”) and between  
6 TUCO and Dairyland Power Cooperative (“Dairyland Spot Contract”).

7 **Q. UNDER WHAT SUPPLY CONTRACTS DID TUCO PURCHASE COAL**  
8 **DURING THE RECONCILIATION PERIOD?**

9 A. TUCO purchased coal during the Reconciliation Period under four “term”  
10 contracts, i.e., contracts having a term of one year or more and two “spot”  
11 contracts, i.e. contracts having a term of less than one year. The four term  
12 contracts were:

- 13 1. Arch 2001 CSA;
- 14 2. Amended and Restated Agreement;
- 15 3. Arch Settlement Agreement; and
- 16 4. Coal Sales Agreement between TUCO and Peabody Coal  
17 Trade, Inc. (“Peabody Coal Trade CSA”).  
18  
19

20 The two spot contracts were the Buckskin Spot Contract and the Dairyland  
21 Spot Contract.

22 **Q. HOW DID THE PRICES PAID BY TUCO FOR COAL SUPPLIES IT**  
23 **OBTAINED IN THE RECONCILIATION PERIOD COMPARE TO**  
24 **COMPARABLE MARKET PRICES?**

1 A. Mr. Panzarino addressed this question in his direct testimony at  
2 page 13:

3 TUCO'S average annual mine cost of coal for Tolk  
4 Station during the Reconciliation Period was  
5 approximately at market in 2004 and was over  
6 \$2.00 per ton below market in 2005. TUCO's  
7 average annual mine cost of coal for Harrington  
8 Station exceeded market by approximately \$1.20  
9 per ton in 2004 and was approximately \$2.00 below  
10 market in 2005. Refer to Attachment PJP-2.  
11

12 I have reviewed Mr. Panzarino's calculations and agree with them. These  
13 figures show that, on average, TUCO coal purchases are approximately 5.2% less  
14 than comparable market pricing during the reconciliation period.

15 **Q. DO YOU BELIEVE SPS/TUCO'S NEGOTIATIONS OF THE VARIOUS**  
16 **COAL SUPPLY AGREEMENTS WERE PRUDENT?**

17 A. Yes, I believe SPS/TUCO's actions were prudent given the provisions of the then  
18 existing coal supply agreements, the scope and scale of SPS's generating  
19 operations, SPS's responsibility to provide reliable, reasonably priced electricity  
20 to its customers, and the state of the coal supply and coal transportation markets at  
21 the time of the agreements were negotiated.

22 **Q. WHAT PRUDENCE CLAIMS DO WITNESSES CARDWELL,**  
23 **FALKENBERG, SCHWARTZ AND ALMON MAKE CONCERNING THE**  
24 **AMOUNTS TUCO PAID FOR COAL DURING THE RECONILIATION**  
25 **PERIOD?**

1 A. Messrs. Cardwell, Falkenberg and Almon do not dispute the prudence of TUCO's  
2 coal purchases. Mr. Schwartz claims that SPS took several imprudent actions  
3 relating to the negotiations.

4 **Q. WOULD YOU PLEASE SUMMARIZE MR. SCHWARTZ'S**  
5 **CONTENTIONS OF IMPRUDENCE SURROUNDING THESE**  
6 **NEGOTIATIONS?**

7 A. Mr. Schwartz contends that the following actions allegedly made by SPS/TUCO  
8 during various negotiations with Arch were imprudent. First, that SPS/TUCO  
9 imprudently agreed to changed coal supply terms and coal quality terms in the  
10 negotiations of the 2001 Amended and Restated Agreement and in the  
11 negotiations of the 2003 Arch Settlement Agreement which allowed Arch to  
12 substitute low Btu coal in place of the 8,800 Btu coal supplied from the Black  
13 Thunder Mine. Second, SPS/TUCO were imprudent in negotiating a "Standstill"  
14 payment to restrict the shipment of low Btu Cordero Rojo coal in the last two  
15 quarters of 2005 and the first quarter of 2006. Third, Mr. Schwartz concludes that  
16 the costs associated with the 2006 Settlement and Release Agreement which  
17 restricted the shipment of low Btu coal were imprudent. Fourth, Mr. Schwartz  
18 claims that SPS/TUCO were imprudent in accepting Arch's new price offer as  
19 part of the price reopener of the Amended and Restated Agreement in light of  
20 supposedly lower offers received from other coal producers.



1           **A.     CHANGES IN COAL SUPPLY TERMS**

2       **Q.     WHAT PROVISIONS IN THE 2001 AMENDED AND RESTATED**  
3           **AGREEMENT DOES MR. SCHWARTZ CLAIM WERE IMPRUDENTLY**  
4           **CHANGED?**

5       A.     Mr. Schwartz cites Sections 1(b), 5(c) and Exhibit B.

6       **Q.     WAS SECTION 1(b) IMPRUDENTLY CHANGED DURING THE**  
7           **NEGOTIATION OF 2001 AMENDED AND RESTATED AGREEMENT?**

8       A.     No. Section 1(b) addresses Arch's right to supply Substitute Coal from mines  
9           other than Black Thunder and Coal Creek. The Amended and Restated  
10          Agreement was originally executed in 1977. The original version of Section 1(b)  
11          set forth in the 1977 agreement provided in pertinent part:

12                               [Seller may deliver] Coal from mines other than  
13                               Seller's Coal Creek or Black Thunder mines ("Substitute  
14                               Coal") located in the same railroad tariff area as Seller's  
15                               Coal Creek and Black Thunder mines. Such Substitute  
16                               Coal shall be sold to Buyer and received at the Units at the  
17                               same price per million BTUs calculated by using the  
18                               formula set forth in Section 8(a) as Buyer then would be  
19                               paying for coal purchased from Seller's Black Thunder  
20                               mine and received at the Units. The Substitute Coal shall  
21                               be within the range of the typical coal characteristics as set  
22                               forth in Exhibit C.

23  
24                               After January 1, 1986, Seller shall not deliver to  
25                               Buyer coal produced from the Coal Creek mine or  
26                               Substitute Coal unless (i) such coal has an average BTU  
27                               content comparable to the average BTU content then being  
28                               delivered from the Black Thunder mine or, (ii) such coal is  
29                               being delivered to alleviate temporary producing or  
30                               operating limitations at the Black Thunder mine or  
31                               imbalances between or among the producing or operating  
32                               capacities and delivery schedules of Seller's Powder River  
33                               Basin mines.

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Mr. Schwartz compares the 1977 text of Section 1(b) to the text of Section 1(b) in the Amended and Restated Agreement in effect on July 1, 2001, which provided in pertinent part:

[Seller may also deliver] Coal from any of the mines [other than Black Thunder or Coal Creek] listed on the attached Exhibit B, entitled “Substitute Source Mines” (“Substitute Coal”). Such Substitute Coal shall be sold to Buyer at the same price per million Btus as Buyer would then be paying for coal purchased from Thunder Basin’s Black Thunder mine. The Substitute Coal shall be within the range of the typical coal characteristics set forth in the attached Exhibit C, entitled “Black Thunder Typical Characteristics”, and shall be burnable at the Units without causing unreasonable operating problems....

Mr. Schwartz uses this comparison to assail TUCO for removing the paragraph in Section 1(b) of the 1977 agreement which precluded coal sales made after January 1, 1986 of coal not having “the average Btu content” of Black Thunder coal – i.e., 8800 Btu coal. Mr. Schwartz’s contract analysis is wrong. In 1985, the parties agreed to the Second Amendment to the original 1977 agreement. The Second Amendment amended Section 1(b) to read:

[Seller may deliver] Coal from mines other than Seller’s Coal Creek or Black Thunder mines (“Substitute Coal”) located in the same railroad tariff area as Seller’s Coal Creek and Black Thunder mines. Such Substitute Coal shall be sold to Buyer and received at the Units at the same price per million BTUs as Buyer would then be paying for coal purchased from Seller’s Coal Creek mine and received at the Units. The Substitute Coal shall be within the range of the typical coal characteristics set forth in Exhibit C. Seller shall promptly notify Buyer when Seller is going to deliver Substitute Coal.

1 As is readily apparent, the provisions in Section 1(b) of the 1977  
2 agreement cited by Mr. Schwartz were deleted in the 1985 Second Amendment,  
3 not in the negotiations preceding the execution of the 2001 Amended and  
4 Restated Agreement. Mr. Schwartz's assertions to the contrary are simply wrong.

5 **Q. WAS SECTION 5(c) IMPRUDENTLY CHANGED DURING THE**  
6 **NEGOTIATION OF THE 2001 AMENDED AND RESTATED**  
7 **AGREEMENT?**

8 A. No. Mr. Schwartz's analysis of asserted "changes" in Section 5(c), which  
9 addresses typical coal characteristics, is wrong for the same reason Mr.  
10 Schwartz's analysis of asserted changes in the Section 1(b) substitution coal  
11 provisions is wrong. Specifically, Mr. Schwartz failed to address the Second  
12 Amendment to the original 1977 Agreement. In the Second Amendment, the  
13 parties amended Section 5(c) to provide in pertinent part:

14 (c) Typical Coal Characteristics  
15

16 Seller represents that the typical coal characteristics  
17 of the production from the Black Thunder mine and the  
18 Coal Creek mine are set forth in Exhibit C.  
19

20 Buyer represents that the Units shall be designed,  
21 constructed and operated in accordance with usual and  
22 customary design and operating standards and tolerances,  
23 to use coal with the characteristics set forth in Exhibit C for  
24 coal from the Black Thunder and Coal Creek mines.  
25

26 If the characteristics of the coal delivered to Buyer  
27 under this Agreement (except for the BTU and sulfur  
28 content of such coal which are separately covered under  
29 Section 8) depart from the range of characteristics for coal  
30 set forth in Exhibit C and Buyer is unable to use such coal

1 in the Unit without causing unreasonable operating  
2 problems, Buyer may reject such coal....

3  
4 The text is identical in all material respects to the text of Section 5(c) in  
5 the 2001 Amended and Restated Agreement in effect on July 1, 2001:

6 **5(c) Typical Coal Characteristics.** Seller  
7 represents that the typical coal characteristics of the  
8 production from the Black Thunder mine and the Coal  
9 Creek mine are set forth in Exhibit C.

10  
11 Buyer represents that the Units were designed and  
12 constructed, and will be operated in accordance with usual  
13 and customary design and operating standards and  
14 tolerances to use coal with the characteristics set forth in  
15 Exhibit C for coal from the Black Thunder and Coal Creek  
16 mines.

17  
18 If the characteristics of the coal delivered to Buyer  
19 under this Agreement (except for the Btu and sulfur content  
20 of such coal which are separately covered under Section 8)  
21 departs from the range of characteristics for coal set forth in  
22 Exhibit C and SPS is unable to use such coal in the Units  
23 without causing unreasonable operating problems, Buyer  
24 may reject such coal...

25  
26 Thus, contrary to Mr. Schwartz's assertions, TUCO did not agree to  
27 material changes in the text of Section 5(c) during the negotiations of the 2001  
28 Amended and Restated Agreement.

29 **Q. DOES THE INCLUSION OF EXHIBIT B TO THE 2001 AMENDED AND**  
30 **RESTATED AGREEMENT CONSTITUTE A MATERIAL CHANGE IN**  
31 **THE AGREEMENT TERMS?**

32 A. No. The 1977 agreement, as amended by the Second Amendment, provided that  
33 Arch could supply Substitute Coal under Section 1(b) only from mines located in  
34 the "same railroad tariff area as Seller's Coal Creek and Black Thunder mines."

1 The “tariff area” referred to the PRB mines from which TUCO could obtain rail  
2 service. In the 2001 Amended and Restated Agreement, Arch and TUCO agreed  
3 to list the “tariff area” mines by name in a new Exhibit B to the agreement. This  
4 change did not substantively change the Agreement terms.

5 **Q. DID SPS ENTER INTO ANY “CHANGED” COAL SOURCE**  
6 **PROVISIONS IN ITS NEGOTIATION OF THE 2003 ARCH**  
7 **SETTLEMENT AGREEMENT?**

8 A. No. The 2003 Arch Settlement Agreement contains coal source and coal quality  
9 provisions that mirror in all material respects the provisions that Mr. Schwartz  
10 mistakenly claimed TUCO agreed to “change” in the negotiations preceding the  
11 2001 Amended and Restated Agreement.

12 **Q. OVERALL, HOW WOULD YOU ASSESS MR. SCHWARTZ’S**  
13 **CONTENTION THAT THE INSERTION OF NEW COAL SUPPLY AND**  
14 **COAL QUALITY TERMS WAS IMPRUDENT?**

15 A. I believe that Mr. Schwartz’s contention is completely baseless since the “new”  
16 contract provisions he claims are imprudent have been in place for over 20 years.

17 **Q. MR. SCHWARTZ ALSO ARGUES THAT TUCO’S NEGOTIATION OF**  
18 **ARCH 2001 CSA DEMONSTRATES THE IMPRUDENCE OF**  
19 **SPS/TUCO’S NEGOTIATION OF THE COAL SOURCE TERMS IN THE**  
20 **2001 AMENDED AND RESTATED AGREEMENT AND THE 2003 ARCH**  
21 **SETTLEMENT AGREEMENT. DO YOU AGREE?**

1 A. No. The Arch 2001 CSA provided that Arch would supply specified volumes of  
2 Black Thunder coal between 2001 and 2005. Mr. Schwartz cites no material in  
3 the record, or elsewhere, indicating that Arch would have agreed to similar source  
4 terms in the 2001 Amended and Restated Agreement and in the 2003 Arch  
5 Settlement Agreement. His assertions are simply unsupported speculation on his  
6 part.

7 **B. STANDSTILL PAYMENTS**

8 **Q. WHAT PRUDENCE CLAIMS DO THESE WITNESSES MAKE**  
9 **CONCERNING THE AMOUNTS TUCO PAID FOR COAL DURING THE**  
10 **RECONILIATION PERIOD?**

11 A. Messrs. Cardwell, Falkenberg and Almon do not dispute the prudence of TUCO's  
12 coal purchases. Mr. Schwartz claims that SPS imprudently permitted TUCO to  
13 make "Standstill Agreement" payments totaling \$3,276,269 during the  
14 reconciliation period (Schwartz, page 15).<sup>1</sup>

15 **Q. DO YOU AGREE WITH MR. SCHWARTZ'S ASSESSMENT THAT THE**  
16 **STANDSTILL PAYMENT NEGOTIATED BETWEEN TUCO AND ARCH**  
17 **WAS IMPRUDENT?**

18 A. No, I believe the standstill agreement was prudent and in the best interest of  
19 SPS's ratepayers and stockholders.

---

<sup>1</sup> Mr. Schwartz has overstated the 2005 Standstill Agreement payments. The actual payments equaled \$3,216,939. Mr. Schwartz apparently assumed an even distribution of tonnage during the months in 2005, i.e., he simply assumed that ½ of the annual tonnage in his table on page 7 of his Direct Testimony moved in the last half of 2005.

1 **Q. WHAT “STANDSTILL AGREEMENT” PAYMENTS IS MR. SCHWARTZ**  
2 **REFERRING TO?**

3 A. Mr. Schwartz is referring to three letter agreements between TUCO and Arch,  
4 dated March 24, 2005, June 30, 2005 and October 27, 2005. These letters are  
5 self-denominated as the “Standstill Agreement” (March 24, letter), the “Standstill  
6 Extension” (June 30, letter)<sup>2</sup> and the “Second Standstill Extension” (October 27,  
7 letter). In these letters, TUCO agreed to pay to Arch an additional \$1.15 per ton  
8 for specified coal sales made by TUCO and Arch between July and December 31,  
9 2005.

10 **Q. HOW DID THE PARTIES DESCRIBE THE DISPUTE THAT WAS THE**  
11 **SUBJECT OF THE STANDSTILL AGREEMENTS?**

12 A. The parties described the dispute involving the permissible sources of coal under  
13 the three Arch/TUCO coal supply contracts in effect during the Reconciliation  
14 Period:

15 “[the dispute involves] a disagreement between the parties  
16 [Arch and TUCO] regarding the supply by Arch of coal  
17 from sources other than the Black Thunder Mine under the  
18 [then Arch] Coal Supply Agreements. TUCO  
19 acknowledges that Arch claims, without limitation, TUCO  
20 has the obligation to accept coal from sources other than  
21 Black Thunder, including without limitation the Cordero  
22 Mine and/or the Caballo Rojo Mine (“Cordero-Rojo Coal”)  
23 so long as such coal is within the range of the typical  
24 characteristics set forth in Exhibits C to the Coal Supply  
25 Agreements, and Arch acknowledges that TUCO claims,  
26 without limitation, it is not obligated to accept Cordero-  
27 Rojo Coal because it causes unreasonable operating

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<sup>2</sup> September 23, 2005 email from Alan Gadby to Jon Kelly extended the Standstill Agreement until October 31, 2005.

1 problems at its customer's plants. Arch has filed, but has  
2 not yet served, a Complaint styled Arch Coal Sales  
3 Company, Inc. v. TUCO, Inc. Case No. 26618 in the  
4 District Court, Sixth Judicial District of Campbell County,  
5 Wyoming (the "Complaint"), which seeks, among other  
6 things a resolution to the foregoing dispute.  
7

8 (October 27 letter at 1).

9 **Q. WHAT WAS THE STATED PURPOSE OF THE JUNE 30, 2005 AND**  
10 **OCTOBER 27, 2005 STANDSTILL AGREEMENTS?**

11 A. The letters memorialize agreements between Arch and TUCO. The key terms  
12 include: 1) TUCO's agreement to pay an extra \$1.15 per ton on specified  
13 shipments during the term of the agreements; 2) Arch's commitment to "supply  
14 only coal from the Black Thunder Mine to TUCO" under the Arch/TUCO  
15 contracts during the term of the agreements; and 3) the parties agreement "to  
16 negotiate in good faith" to resolve the disputes.

17 **Q. WHY DOES MR. SCHWARTZ CONTEND THE STANDSTILL**  
18 **AGREEMENT PAYMENTS WERE IMPRUDENT?**

19 A. Mr. Schwartz has three primary reasons why he believes the Standstill Agreement  
20 payments are imprudent. First, he believes SPS/TUCO were imprudent because  
21 the Standstill Agreement payments were unnecessary if SPS had not agreed to  
22 "new" contract language which removed restrictions on the shipment of low Btu  
23 coal. Second, Mr. Schwartz believed that SPS/TUCO were imprudent for not  
24 litigating the Standstill dispute. Third, Mr. Schwartz believed that the \$1.15 per  
25 ton Standstill fee paid more to Arch than Arch could have earned in the  
26 marketplace.



1 **Q. ARE MR. SCHWARTZ’S THREE CONTENTIONS CORRECT?**

2 A. No, they are all incorrect.

3 **Q. WHY IS MR. SCHWARTZ’S CONTENTION ABOUT USING THE**  
4 **“NEW” CONTRACT LANGUAGE TO FORESTALL THE SHIPMENT OF**  
5 **LOW BTU COAL INCORRECT?**

6 A. The reason he is incorrect is that the contract language is not “new” as Mr.  
7 Schwartz claims. The 2005-2006 coal supply dispute focused on the parties  
8 disputed construction of substitute coal provisions in the Amended and Restated  
9 Agreement and Arch Settlement Agreement.

10 As I discussed above, the disputed contract language is not new. Rather, it  
11 has been in use for over 20 years.

12 **Q. DO YOU AGREE WITH MR. SCHWARTZ’S ALTERNATIVE**  
13 **CONTENTION THAT SPS WAS IMPRUDENT FOR NOT DIRECTING**  
14 **TUCO TO “ENFORCE” ITS CONTRACT RIGHTS RATHER THAN**  
15 **MAKING THE STANDSTILL PAYMENTS DURING THE**  
16 **RECONCILIATION PERIOD?**

17 A. The dispute between Arch and TUCO involved Arch’s coal supply rights and  
18 obligations under the Arch Amended and Restated Agreement and the Arch  
19 Settlement Agreement. These long-term agreements call for TUCO to purchase  
20 approximately [REDACTED]<sup>3</sup> of coal between 2006 and 2017. Arch’s position  
21 was that it could supply all of these tons from sources TUCO claimed SPS could

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<sup>3</sup> See Exhibit AXM10-46(CONF).

1 not practically utilize. Given the tonnages involved, the financial stakes for  
2 TUCO and SPS were enormous, and resolution of the dispute turned on contested  
3 contract interpretation issues.

4 Utilities and other businesses faced with such enormous liability claims  
5 routinely enter into standstill agreements. These agreements permit the parties to  
6 evaluate their legal positions, determine their financial risks and provide a safe  
7 haven for settlement negotiations. That is exactly what happened here, SPS  
8 agreed to pay Arch \$3.2 million during the reconciliation period -- \$1.15 per ton  
9 on tons covered by the Standstill Agreements.<sup>4</sup> In return, Arch agreed to supply  
10 TUCO (and SPS) 8,800 Btu Black Thunder coal at prices well below the current  
11 market levels during the reconciliation period.

12 The Standstill Agreements gave something to Arch (an additional \$1.15  
13 per ton); gave something to TUCO/SPS (a continued supply of low-cost high Btu  
14 coal that did not cause operational problems for SPS) and gave TUCO and SPS  
15 time to carefully evaluate their legal options and financial risks. SPS's actions  
16 were reasonable and prudent, in my opinion.

17 **Q. WHY WAS MR. SCHWARTZ'S ASSERTION THAT THE \$1.15 PER TON**  
18 **PAYMENT WAS IMPRUDENT ALSO INCORRECT?**

---

<sup>4</sup> The Standstill Agreements also called for payments of \$1.50 per ton for coal shipped in after the Reconciliation Period.

1 A. Mr. Schwartz's assertion was incorrect for three reasons. First, his assumption  
2 that SPS/TUCO could have simply resold the low Btu coal in the open market and  
3 avoided the \$1.15 per ton standstill payment is faulty. Second, his assertion that  
4 the \$1.15 per ton payment resulted in a return greater than could be achieved  
5 under the terms of the coal supply agreements is speculative at best. Third, he  
6 does not take into consideration the costs associated with taking the low Btu coal  
7 in his assessment.

8 **Q. WHAT WAS FAULTY ABOUT MR. SCHWARTZ'S FIRST**  
9 **ASSUMPTION REGARDING THE RESELLING OF THE LOW BTU**  
10 **COAL?**

11 A. Mr. Schwartz assumes that SPS/TUCO has unobstructed access to the coal market  
12 to sell the coal it purchases under its coal supply agreements with Arch. However,  
13 under the terms of Section 15 of the Amended and Restated Agreement and  
14 Section 14 of the Arch Settlement Agreement, SPS/TUCO does not have the right  
15 to resell any quantity of coal delivered under either agreement, without first  
16 negotiating with Arch for the repurchase of the coal. Section 15 states in  
17 pertinent part:

18  
19 Buyer shall have the right to send such coal  
20 to other SPS electric generating facilities, to  
21 sell such coal to others or to use such coal  
22 for any other purpose it desires; provided,  
23 however, that Buyer shall not have the right  
24 to resell any quantity of coal delivered under  
25 this Agreement except to SPS for use at  
26 SPS' Tolk Generating Station or Harrington  
27 Generating Station without first negotiating

1 in good faith with Seller for Seller's re-  
2 purchase of such coal. (Emphasis Added)  
3  
4

5 From an economic perspective, the contractual repurchase option retained  
6 by Arch allows Arch to retain a majority, if not all, of the economic rents from the  
7 sale of coal.<sup>5</sup> This is because Arch can limit SPS/TUCO's ability to quickly resell  
8 the coal on the open market. The lack of expedited selling rights limits the  
9 options available to SPS/TUCO, and effectively retains the economic rents from  
10 the coal sales with Arch. Without the right to resell coal in a quick manner at  
11 market prices, the basis of Mr. Schwartz's argument falls apart.

12 **Q. ON WHAT BASIS DID MR. SCHWARTZ DECIDE THAT THE \$1.15 PER**  
13 **TON STANDSTILL PAYMENT WOULD OVER COMPENSATE ARCH?**

14 A. Mr. Schwartz based his analysis on Mr. Panzarino's Testimony Attachment PJP-  
15 3. Mr. Panzarino's analysis compared the spread in market price per ton of 8,400  
16 Btu and 8,800 Btu coal for the third and fourth quarters of 2005 to the Standstill  
17 payment, and found that the Standstill payment was lower than the spread in the  
18 market rates. Mr. Schwartz criticized Mr. Panzarino's analysis for allegedly not  
19 taking into consideration Arch's obligation to sell coal to SPS/TUCO at contract  
20 prices and not market prices, so Mr. Schwartz modified Mr. Panzarino's analysis  
21 to include the impact of the contract price of coal. Mr. Schwartz also modified

---

<sup>5</sup> Mr. Schwartz indicated in his deposition that he does not believe Section 15 limits SPS/TUCO's right to resell the coal as long as SPS/TUCO first make an "offer in good faith" to Arch to resell the coal at market price. Schwartz deposition at 60. I believe Mr. Schwartz has misconstrued the terms of the agreement. Section 15 does not call for a simple offer to be made to Arch, but rather for the parties to enter into good faith negotiations. There is a substantial difference between presenting an offer and negotiating an agreement.

1 Mr. Panzarino's analysis to include alleged first quarter 2006 market and contract  
2 prices.

3 **Q. WHAT DID MR. SCHWARTZ CONCLUDE FROM HIS ANALYSIS?**

4 A. Mr. Schwartz concluded that SPS/TUCO overpaid Arch by approximately \$0.14  
5 per ton in 3Q 2005 and by approximately \$0.88 per ton in 1Q 2006, but underpaid  
6 Arch by \$0.74 per ton in 4Q 2005.

7 **Q. ARE MR. SCHWARTZ'S CONCLUSIONS CORRECT?**

8 A. Mr. Schwartz's conclusions are speculative at best, and do not necessarily support  
9 his conclusion that SPS/TUCO overpaid Arch. Mr. Schwartz's analysis shows  
10 everything on a price per ton basis. However, it is the overall net gain or loss on  
11 the transactions that dictate whether SPS/TUCO overpaid Arch or not. Table 1  
12 below calculates the net gain and loss taking into consideration actual tons  
13 covered under the applicable coal supply agreements and the market and contract  
14 spreads for 3Q 2005 and 4Q 2005.<sup>6</sup>

---

<sup>6</sup> I have not included the January and February 2006 time period that was included by Mr. Schwartz because it is outside the Reconciliation Period.

**Table 1**  
**SPS/TUCO 2005 Underpayments From StandStill**  
**Agreement Under Schwartz's Market Trade Assumption**

<u>Time Period</u>	<u>Difference in Contract and Market Per Ton</u> <sup>2</sup>	<u>Standstill Payment Per Ton</u> <sup>2</sup>	<u>Amount Standstill Greater/(Less) Than Market Gain</u>	<u>Tons Purchased By SPS</u>	<u>Over/(Under) Payments Made by SPS/TUCO</u> <sup>3</sup>
(1)	(2)	(3)	(4)	(5)	(6)
1. 3Q 2005	\$1.007	\$1.15	\$0.143		
2. 4Q 2005	\$1.889	\$1.15	(\$0.739)		
3. Total <sup>1</sup> (L1+L2)					(\$1,097,602)

<sup>1</sup> Mr. Panzarino did not develop market values for 2006.

<sup>2</sup> Schwartz at page 21.

<sup>3</sup> Column (4) x Column (5).

2

3 As Table 1 above shows, SPS/TUCO would have paid Arch nearly \$1.1 million  
4 more in 2005 if it followed the strategy suggested by Mr. Schwartz. Table 1 also  
5 demonstrates the Standstill Agreement payment when compared to market prices  
6 is in a reasonable range.

7 **Q. AT PAGE 21 OF HIS TESTIMONY MR. SCHWARTZ CONCLUDES**  
8 **THAT ARCH COULD NOT HAVE REPLACED, ON SHORT NOTICE,**  
9 **ALL OF ITS 8,800 BTU COAL COVERED BY THE STANDSTILL**  
10 **AGREEMENT PAYMENTS WITH 8,400 BTU COAL. DO YOU AGREE?**

11 A. No, I do not agree with Mr. Schwartz's conclusion. In my opinion, there is  
12 sufficient capacity available at mines in the PRB to supply the required amounts

1 of 8,400 Btu coal, and sufficient activity in the primary and secondary coal  
2 markets to allow Arch to provide the lower Btu coal. Arch could have produced  
3 the additional coal at its own Coal Creek mine or provided the coal from another  
4 mine in the PRB as a spot coal purchase. A prime example of the type of spot  
5 coal activity is TUCO's ability to purchase the 8,550 Btu coal from Dairyland and  
6 the 8,400 Btu coal from Buckskin in July, 2005 on extremely short notice.<sup>7</sup> It is  
7 my experience that there is more than enough coal buying and selling activity to  
8 supply the coal at the required volumes.

9 **Q. DID MR. SCHWARTZ'S ANALYSIS OF THE STANDSTILL PAYMENT**  
10 **EXCLUDE ANY OTHER RELEVANT FACTORS?**

11 A. Yes, Mr. Schwartz failed to consider the costs to derate the generating stations if  
12 SPS/TUCO had accepted the unlimited delivery of low Btu coal.

13 **Q. HOW WOULD THE COST OF DERATING THE PLANTS COMPARE TO**  
14 **THE STANDSTILL PAYMENT?**

15 A. Based on an analysis performed by SPS/TUCO, the cost to derate the generating  
16 stations would be vastly greater than the cost of the Standstill Agreement.

17 As indicated in the Rebuttal Testimony of SPS's Mr. Imbler, SPS/TUCO  
18 determined that the cost of derating Tolc in 2005 during the period covered by the  
19 Standstill Agreement would have been [REDACTED]. Based on this analysis,

---

<sup>7</sup> In a related issue, Mr. Schwartz's claims on page 20 and 21 of his Direct Testimony that Mr. Panzarino's analysis of the Standstill Agreement Payments is based on buying and selling coal via OTC market contracts is incorrect. I believe that Mr. Panzarino used the OTC price in his Standstill Payment analysis as a surrogate for the then current spot prices of 8,800 and 8,400 Btu coal, and not using the OTC market to buy or sell the coal as Mr. Schwartz implies.

1 SPS/TUCO was economically better off paying Arch the Standstill Agreement  
2 payments than accepting the low Btu coal.

3 **B. SETTLEMENT AND RELEASE AGREEMENTS**

4 **Q. DO YOU AGREE WITH MR. SCHWARTZ THAT SPS IMPRUDENTLY**  
5 **PERMITTED TUCO TO ENTER INTO THE JUNE 2006 SETTLEMENT**  
6 **AGREEMENT?**

7 A. No, I do not. The Settlement Agreement constituted a reasonable allocation of  
8 economic costs and risks. Under the Settlement Agreement, Arch agreed that the  
9 principal source of supply for Tolk and Harrington under both the Arch Amended  
10 and Restated Agreement and the Arch Settlement Agreement will be Black  
11 Thunder coal. In return, TUCO agreed to accept specified shipments of lower Btu  
12 Coal Creek coal during the terms of the two agreements and made some modest  
13 pricing concessions to Arch. The deal made good, and prudent, financial sense  
14 for both TUCO and SPS.

15 **Q. DID MR. SCHWARTZ MAKE ANY OTHER ASSERTIONS ABOUT THE**  
16 **PRUDENCE OF SPS/TUCO'S AGREEMENTS LIMITING THE**  
17 **DELIVERY OF SUBSTITUTE COAL?**

18 A. Yes, Mr. Schwartz asserted that SPS/TUCO were imprudent in negotiating the  
19 Settlement and Release Agreement which limited the supply of low Btu coal  
20 because it would allegedly cost SPS/TUCO approximately \$150 million on a  
21 nominal basis over the 2005 to 2017 time frame (Schwartz, page 17).



1 **Q. DO YOU AGREE WITH MR. SCHWARTZ'S COST ASSESSMENT OF**  
2 **THE SETTLEMENT AND RELEASE AGREEMENT?**

3 A. No, I believe Mr. Schwartz's cost estimates are extraordinarily speculative. I also  
4 believe he has misinterpreted key parts of the Settlement and Release Agreement  
5 leading to an overstatement of the costs of the Agreement, and he failed to  
6 balance the cost of the Agreement against the gains of not burning low Btu  
7 substitute coal. Finally, Mr. Schwartz's criticisms of SPS's economic evaluation  
8 of the Settlement and Release Agreement are unsupported and unfounded.

9 **Q. HOW ARE MR. SCHWARTZ'S COST ESTIMATES SPECULATIVE?**

10 A. For example, in all of the cost analyses he displays on pages 16 and 17 of his  
11 testimony in which he forecasts future coal tons to Tolk and Harrington, Mr.  
12 Schwartz assumes that in each future year, SPS/TUCO will not have any force  
13 majeure events, and both SPS plants will take the full allotment of coal. It is  
14 suspect to assume that the plants will not have any unplanned outages that will  
15 mitigate future coal consumption.

16 **Q. ARE THERE ANY OTHER SPECULATIVE ASPECTS TO MR.**  
17 **SCHWARTZ'S COST ESTIMATES?**

18 A. Yes, the coal price forecast Mr. Schwartz uses on page 17 of his testimony  
19 assumes prices will always be below the \$14.00 per ton price floor. While SPS  
20 produced this forecast in its normal course of business, Mr. Schwartz, being a  
21 self-acknowledged expert in the field of coal procurement, should have known  
22 that recent history has shown PRB coal prices have not moved in a smooth

1 pattern, but have experienced price spikes approximately every five years.  
2 Attachment TDC-R2 to this testimony displays a graph of PRB 8,800 Btu coal  
3 prices over the last 11 years, which shows two clear spikes in coal prices over the  
4 period.<sup>8</sup>

5 **Q. WHAT DOES IT MEAN THAT MR. SCHWARTZ FAILED TO BALANCE**  
6 **HIS COSTS ESTIMATES AGAINST THE BENEFITS OF THE**  
7 **SETTLEMENT AND RELEASE AGREEMENT?**

8 A. Mr. Schwartz tabulates what he asserts are the costs of entering into the  
9 Settlement and Release Agreement, but he never acknowledges the costs that SPS  
10 avoided by signing the Agreement.

11 **Q. WHAT BENEFITS DID SPS GAIN BY ENTERING INTO THE**  
12 **SETTLEMENT AND RELEASE AGREEMENT?**

13 A. The primary benefits accrued are limits on the amount of low Btu coal which  
14 Arch may deliver, a near guaranteed supply of high Btu coal over the life of the  
15 Agreement, and an ability to operate Tolk and Harrington at higher levels of  
16 output. Under the Settlement and Release Agreement, Arch is limited to  
17 supplying no more than 2 million tons per year of low Btu Coal Creek coal  
18 between 2006 and 2010 and no more than 2.7 million tons per year of low Btu

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<sup>8</sup> The latter of the price spikes occurred during the price reopener negotiations under the Amended and Restated Agreement.

1 Coal Creek coal between 2011 and 2017.<sup>9</sup> While it is still debatable whether  
2 Arch could deliver an unlimited supply of low Btu substitute coal under the  
3 Amended and Restated Agreement and the Arch Settlement Agreement as it  
4 contended, the Settlement and Release Agreement quashes this debate by clearly  
5 limiting delivery of the amount of any low Btu coal.

6 In addition to the provision limiting the amount of coal from Coal Creek,  
7 Arch and SPS/TUCO agreed to modify Exhibit B of both the Amended and  
8 Restated Agreement and the Settlement and Release Agreement to limit the  
9 delivery of substitute coal from only the North Antelope/Rochelle Mine Complex,  
10 the Antelope Mine Complex and the School Creek Mine Complex. All three  
11 mine complexes are currently shipping, or are expected to ship in the future in the  
12 case of the School Creek Mine, what is generally accepted as 8,800 Btu coal.  
13 Moreover, SPS/TUCO and Arch also agreed to amend Section 1.2.b of the  
14 Settlement and Release Agreement and the Amended and Restated Agreement to  
15 ship other 8,800 Btu coal as long as the new coal has materially the same  
16 characteristics of Black Thunder coal. This guarantee of high Btu coal will ensure  
17 that the Tolk and Harrington plants will operate at the highest levels of output  
18 possible given the relative performance of the plants.

---

<sup>9</sup> Additionally, the Settlement and Release Agreement only provides Arch the option to ship the low Btu coal, and not the obligation. It is possible that Arch will not ship the low Btu coal in some years.

1 **Q. WHAT WAS THE VALUE OF THESE BENEFITS?**

2 A. SPS estimated that the net present value of plant derations and lost capacity if it  
3 did not enter into the Settlement and Release Agreements<sup>10</sup> would equal at least  
4 [REDACTED] (if all coal equaled 8,330 Btu's per pound).<sup>11</sup> On the other hand,  
5 SPS calculated the maximum net present value of plant derations to equal only  
6 [REDACTED] under the Settlement and Release Agreement (if Arch shipped  
7 approximately 2 million tons per year of 8,330 Btu per pound coal).<sup>12</sup> Subtracting  
8 the values under the two scenarios produces a difference of [REDACTED] on a  
9 real dollar avoided basis.

10 **Q. HOW DOES THIS VALUE COMPARE TO MR. SCHWARTZ'S**  
11 **ESTIMATED COSTS OF THE SETTLEMENT AND RELEASE**  
12 **AGREEMENTS?**

13 A. Mr. Schwartz estimated the costs of these Agreements to be \$147.6 million on a  
14 nominal dollar basis. To make an "apples to apples" comparison, I calculated the  
15 net present value of Mr. Schwartz's cashflows using SPS' internal discount rate of  
16 [REDACTED].<sup>13</sup> As shown in Attachment TDC-R3(CONF), the net present value of Mr.

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10 The net present value analysis performed by SPS of the costs and benefits of the Settlement and  
Release Agreement [REDACTED] for future price  
11 reopeners under the Amended and Restated Agreement. See Exhibit AXM10-46(CONF).  
See Exhibit AXM10-46(CONF) at Page 2. [REDACTED]

12 Also under the Settlement and Release Agreement the net present value of lost capacity could be  
zero. The net present value of the derations is described as a maximum since there is no guarantee  
under the Agreements that Arch will ship the maximum allowable low Btu coal. The Agreements  
only give Arch the option to ship the coal, not the obligation to ship it, so the cost of deration  
could be less than the [REDACTED] estimated by SPS.

13 See Exhibit AXM10-46(CONF) at Page 7.

1 Schwartz's cost is approximately [REDACTED], substantially less than the benefit  
2 gained by entering into the agreement [REDACTED].<sup>14</sup>

3 **Q. DOES MR. SCHWARTZ HAVE ANY OTHER ISSUES WITH**  
4 **SPS/TUCO'S DECISION TO ENTER INTO THE SETTLEMENT AND**  
5 **RELEASE AGREEMENTS?**

6 A. Yes, Mr. Schwartz at page 27 of this Direct Testimony claims that SPS's  
7 economic analysis of the Agreements was "unreasonably conservative," and that  
8 SPS should have investigated the modification of the SPS generating stations to  
9 more effectively burn low Btu coal.

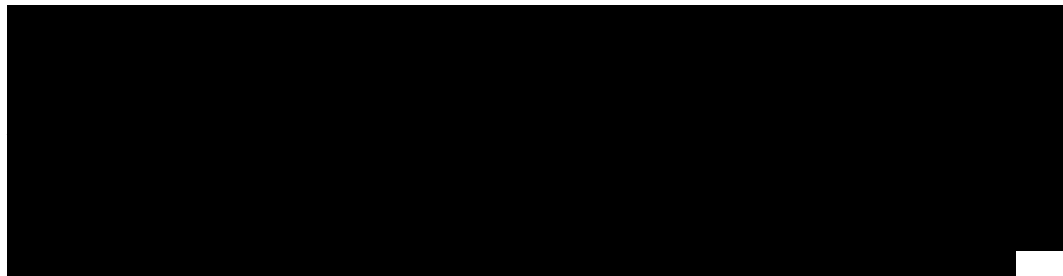
10 **Q. WHAT WERE MR. SCHWARTZ'S CRITICISMS OF SPS'S**  
11 **ASSUMPTIONS?**

12 A. Mr. Schwartz felt that SPS's assumption that one pulverizer mill per unit would  
13 always be out of service for maintenance was too conservative. He also believed  
14 that the assumption that Arch would only ship low Btu coal was unreasonably  
15 conservative as well.

16 **Q. WHY DO YOU BELIEVE SPS'S ASSUMPTION ABOUT PULVERIZER**  
17 **MILL OPERATIONS IS REASONABLE?**

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14



1 A. While I am not a mechanical engineer, it appears to me that the plant builders  
2 expected one mill to be consistently down for maintenance. Page 1 of Exhibit  
3 AXM10-41 contains a copy of the Contract Data Sheet for Tolk Station (“Data  
4 Sheet”). According to the Data Sheet, both of the units at Tolk Station were rated  
5 at 520 MW using an assumed 8,500 Btu Black Thunder coal. The Data Sheet also  
6 shows the plant was constructed with 6 pulverizer mills. Exhibit AXM10-43  
7 includes an analysis of the Tolk Unit generating capacity at various coal heating  
8 values, including operations assuming 8,500 Btu coal. Page 14 of Exhibit  
9 AXM10-43 shows that, with 5 mills in service, each unit’s output would range  
10 from 493.9 MW to 567.4 MW depending upon controllable mill capacity. The  
11 520 MW rated capacity listed in the Data Sheet lies nearly in the middle of each  
12 unit’s output range of 8,500 Btu coal. It would appear, therefore, that the Data  
13 Sheet assumed that one mill would always be off-line during normal operations.

14 **Q. WHAT WAS MR. SCHWARTZ’S ISSUE WITH SPS’S ASSUMPTION OF**  
15 **ONLY RECEIVING LOW BTU COAL?**

16 A. Mr. Schwartz believes that SPS should have investigated the capital costs to allow  
17 the SPS generating stations to use low Btu coal, as other Texas coal-fired stations  
18 use.

19 **Q. DO YOU THINK MR. SCHWARTZ IS CORRECT ABOUT THE NEED**  
20 **FOR A CAPITAL COST ANALYSIS?**

21 A. I believe, based on the Rebuttal Testimony of SPS’s Mr. Gonzales and on the  
22 documents produced in this proceeding, that SPS/TUCO did not have the time to

1 perform a detailed capital analysis given the threat of Arch delivering large  
2 volumes of substitute low Btu coal. Therefore, the costs of capital improvement  
3 were not necessary for the Settlement and Release Agreement analysis.

4 Mr. Gonzales indicates that a comprehensive study of making capital  
5 changes to the SPS plants would take between 13 and 19 months. Moreover, even  
6 if the study concluded that the changes were economically and operationally  
7 feasible, Mr. Gonzales believes that it would take anywhere from an additional 12  
8 to 40 months before commercial operations could begin burning the lower Btu  
9 substitute coal. During this time span that SPS would be studying and making  
10 changes to its generating stations, Arch could have been shipping low Btu  
11 substitute coal, effectively derating the stations for the entire time period. This  
12 derating would have occurred directly during a period in which SPS knew it  
13 [REDACTED]. Page 1 of Exhibit  
14 AXM10-46(HS) contains an internal SPS memorandum discussing available SPS  
15 generating capacity over the 2006 to 2010 time frame. [REDACTED]

16 [REDACTED]  
17 [REDACTED]  
18 [REDACTED]  
19 [REDACTED]  
20 [REDACTED]  
21 [REDACTED]

22 [REDACTED] Given the time to implement the recommendations of a plant modification

1 plan, and given SPS's known [REDACTED]

2 [REDACTED], I believe SPS made the prudent decision to exclude the capital  
3 cost analysis from its study.

4 **Q. WHAT ABOUT MR. SCHWARTZ'S CLAIM THAT OTHER TEXAS  
5 UTILITIES USE LOW BTU COAL AT THEIR GENERATING  
6 STATIONS, AND THEREFORE SPS SHOULD ALSO USE LOW BTU  
7 COAL?**

8 A. Mr. Schwartz's claim is a non-starter. Power generating stations are not "cookie-  
9 cutter" operations, whereby each operates in the same fashion. Instead,  
10 generating plants are constructed to meet certain needs given construction  
11 specifications and operating inputs. Just because other generating plants in Texas  
12 were designed and constructed to burn low Btu coal, does not mean the SPS  
13 stations should also burn low Btu coal.<sup>15</sup>

14 **C. MARKET PRICE REOPENER**

15 **Q. ON WHAT BASIS DOES MR. SCHWARTZ CLAIM THAT THE 2006  
16 PRICE REOPENER AGREEMENT WAS IMPRUDENT?**

17 A. Mr. Schwartz bases his claim on an economic analysis performed by SPS/TUCO  
18 which Mr. Schwartz asserts shows a bid presented by Kiewit for Buckskin coal  
19 that would accrue [REDACTED]

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<sup>15</sup> Mr. Schwartz states at pages 81 and 82 of his January 11, 2007 deposition that some plants that he listed on page 29 in his testimony were designed and constructed to burn Texas lignite. Specifically, he lists three plants that continue to use lignite. This is further proof that all Texas power generating plants are not using low Btu PRB coal.



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[REDACTED]

[REDACTED]

**Q. IS MR. SCHWARTZ’S ASSESSMENT CORRECT?**

A. No, Mr. Schwartz’s assessment is incorrect because he based his claim on an intermediate analysis prepared by SPS and not SPS’s final analysis. Mr. Schwartz drew his savings figures from Exhibit AXM10-39(HS), Page 2 of 17, which shows a savings figure of [REDACTED]

[REDACTED] coal over the use of Thunder Basin coal. But as SPS explains in an analysis summary contained on Page 12 of Exhibit AXM10-39(HS), [REDACTED]

[REDACTED]

[REDACTED]. In

actuality, as shown on Page 1 of Exhibit AXM10-39(HS), SPS determined the net

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>16</sup>

**Q. EVEN AT A [REDACTED] SAVINGS, SPS WOULD HAVE BENEFITED MORE FROM THE KIEWIT OFFER. WHY DID IT NOT ACCEPT THE LOWER OFFER?**

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<sup>16</sup> [REDACTED]

1 A. As SPS explained in its Response to TIEC’s RFI 22-10, the analysis takes into  
2 consideration mine, transportation and other associated costs, but not system costs  
3 associated with lost MW due to the use of lower Btu coal and the effects on SPS’s  
4 generating units.

5 **Q. WERE THERE ANY OTHER FACTORS THAT MADE THE BUCKSKIN**  
6 **BID UNACCEPTABLE?**

7 A. Yes, the bid received from Buckskin was non-conforming to the terms of the  
8 Request For Proposal (“RFP”) issued as part of the price reopener.

9 **Q. HOW WAS THE BUCKSKIN BID NON-CONFORMING?**

10 A. The Buckskin bid was non-conforming to SPS/TUCO’s RFP in several ways.  
11 First, the RFP called for a term coal supply agreement with a term of July 1, 2006  
12 through June 30, 2011.<sup>17</sup> The Buckskin bid only provided for a term from [REDACTED]  
13 [REDACTED].<sup>18</sup> Second, the RFP required the delivery of a minimum of 23.295 trillion  
14 Btu of coal in both 2006 and 2011.<sup>19</sup> The Buckskin bid provided for [REDACTED]  
15 [REDACTED]. Third, the RFP called for coal quality specification limits as  
16 shown in Exhibit A of the RFP.<sup>20</sup> A comparison of the quality specification limits  
17 in Exhibit A of the RFP to the coal quality specifications in the Buckskin bid  
18 shows that several of the Buckskin coal quality standards were outside the  
19 allowable specifications. For example, percentage of hydrogen in the ultimate as

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<sup>17</sup> See Exhibit –TIEC14-22 at Page 1.

<sup>18</sup> See Exhibit AXM10-39(HS), Attachment HS-1.

<sup>19</sup> See Exhibit –TIEC14-22 at Page 6. The RFP also included an option for 5.18 trillion Btu.

<sup>20</sup> See Exhibit –TIEC14-22 at Page 1.

1 received analysis in the RFP called for a range of 3.34 to 3.70 percent.<sup>21</sup> The  
2 average hydrogen percentage in the Buckskin coal was [REDACTED], which  
3 is outside the acceptable range.<sup>22</sup> Similarly, the Hardgrove Grindability Index  
4 called for a range of between 44 and 60.<sup>23</sup> However, the Buckskin coal has a  
5 mean Hardgrove Grindability Index of [REDACTED], which is again outside the range of the  
6 RFP's coal characteristics.<sup>24</sup>

7 **Q. WAS THE BUCKSKIN BID THE ONLY NON-CONFORMING BID?**

8 A. [REDACTED]  
9 [REDACTED]  
10 [REDACTED]  
11 [REDACTED]<sup>25</sup>

12 **Q. AT PAGE 24 OF HIS TESTIMONY, MR. SCHWARTZ CLAIMS THAT**  
13 **SPS DID NOT PROVIDE AN ANALYSIS OF THE EXPECTED**  
14 **DERATING OF TOLK. IS IT POSSIBLE TO DETERMINE IF THE**  
15 **COST OF DERATING TOLK IS MORE COSTLY THAN THE GAINS**  
16 **FROM USING THE BUCKSKIN COAL?**

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<sup>21</sup> See Exhibit –TIEC14-22 at Page 4.  
<sup>22</sup> See Exhibit AXM10-39(HS), Attachment HS-2.  
<sup>23</sup> See Exhibit –TIEC14-22 at Page 4.  
<sup>24</sup> See Exhibit AXM10-39(HS), Attachment HS-3.  
<sup>25</sup> See Exhibit AXM10-39(HS), Attachment HS-18.

1 A. As Mr. Schwartz indicates on page 24-25 of his testimony, there is not a  
2 significant difference in the average Btu value of the Buckskin coal and the low  
3 Btu coal SPS could receive under the Settlement and Release Agreement. I  
4 explained earlier that SPS calculated the net present value of the cost of derating  
5 Tolc for use of the low Btu coal under the Settlement and Release as [REDACTED]  
6 [REDACTED].

7 Without the Settlement and Release Agreement, Arch could have  
8 maintained its position regarding the right to furnish unlimited low Btu coal. In  
9 time periods where the market price between 8,800 Btu coal and 8,400 Btu coal  
10 difference increased substantially, Arch may have had an economic incentive for  
11 SPS to receive the lower Btu coal. After matching the price reopener for a  
12 qualified bid and based on Arch's position, Arch could have switched the source  
13 of coal from 8,800 to something of lower quality.

14 Attachment TDC-R4(CONF) to this testimony shows the net present value  
15 of the derating costs of the Settlement and Release Agreement over the 2006 to  
16 2010 time frame to be approximately [REDACTED].<sup>26</sup> Given that the Settlement  
17 and Release agreement only permits a maximum of 2 million tons per year of low  
18 Btu coal, while Mr. Schwartz states that SPS would have received approximately  
19 2.8 million tons of Buckskin coal, the [REDACTED] derating costs is an extremely

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<sup>26</sup> The Amended and Restated Agreement calls for another price reopener at the beginning of 2011 therefore limiting the relevant analysis period of the Buckskin coal to the 2006 to 2010 timeframe. According to the Settlement and Release Agreement, Arch is limited to delivering 2 million tons per year of low Btu coal during the 2006-2010 time period, and 2.7 million tons per year of low Btu coal during the 2011-2017 timeframe.

1 conservative estimate of the cost of derating and is significantly higher than the  
2 [REDACTED] in savings that SPS would gain by switching to Buckskin coal.

3 **Q. SO WAS SPS PRUDENT IN ACCEPTING ARCH'S FINAL OFFER OF**  
4 **\$18.02 PER TON IN THE AMENDED AND RESTATED PRICE**  
5 **REOPENER?**

6 A. Yes, SPS was prudent in accepting the Arch offer when all relevant costs,  
7 including derating costs, are accounted for in a full analysis.

**IV. PRUDENCE OF SPS'S MITIGATION  
STRATEGY TO CONSERVE COAL INVENTORY**

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**Q. HAVE YOU ADVISED AND CONSULTED WITH OTHER UTILITIES CONCERNING ISSUES RELATING TO THE MANAGEMENT OF INVENTORY DURING THE COURSE OF YOUR CONSULTING PRACTICE?**

A. Yes.

**Q. IN YOUR EXPERIENCE, DO UTILITIES KEEP A LEVEL OF INVENTORY LARGE ENOUGH TO ALLOW THE UTILITY TO SUSTAIN NORMAL OPERATIONS THROUGH A SERIOUS DELIVERY SERVICE CRISIS?**

A. No. The purpose of inventory is not to insure against extended service disruptions. Instead, utilities attempt to set the level of inventory that will protect against short run variations in delivery schedules over reasonably foreseeable lengths of time. No utility could have been able to foresee the impact of the May 2005 rail service events or known how long the events would last.

**Q. WHAT WAS THE CAUSE OF THE SERVICE DISRUPTION THAT BEGAN IN MAY 2005?**

A. On May 14 and 15, 2005, two different coal trains derailed while operating on the UP/BNSF Joint Line (“Joint Line”) serving the southern coal mines in the PRB. The railroads concluded that the derailments were caused by track that had become unstable from a lack of maintenance and the accumulation of coal dust in

1 the roadbed. BNSF, which is responsible for maintaining the Joint Line,  
2 concluded that a significant portion of the Joint Line would require extensive  
3 maintenance that would extend into late 2005. The derailments, along with the  
4 subsequent maintenance blitz and huge increases in other product lines traversing  
5 the rail systems, caused severe disruptions to the Joint Line's operations, limiting  
6 delivery to well below historic levels when measured as a percentage of total  
7 demand.

8 **Q. IN YOUR OPINION, SHOULD SPS HAVE EXPECTED THE TYPE OF**  
9 **RAIL SERVICE DISRUPTION THAT WAS EXPERIENCED IN 2005?**

10 A. No. The disruptions that occurred in past time periods had either been minor, or  
11 were historical anomalies that no reasonable utility had belief to expect would  
12 happen again.

13 **Q. WAS THERE ANY REASON FOR UTILITIES TO BE CONCERNED**  
14 **THAT AN EXTENDED DISRUPTION IN PRB COAL**  
15 **TRANSPORTATION WAS GOING TO OCCUR IN 2005?**

16 A. No. Neither UP nor BNSF were involved in a merger in 2005. Major mergers  
17 have typically led to service disruptions. To the extent the BNSF and UP  
18 indicated that they were concerned about the buildup of coal dust in the PRB, the  
19 electric utility industry believed that the rail providers were addressing the  
20 problem in their maintenance programs. In my view this belief is reasonable.  
21 The BNSF rate structure is intended to recover its costs of providing service,  
22 which includes any costs associated with maintaining its lines. Neither BNSF,

1 nor UP, provided any indications going into 2005 that they believed their  
2 respective rail systems, or the Joint Line, were in any way compromised by the  
3 build up of coal dust.

4 **Q. IN YOUR OPINION SHOULD SPS HAVE ANTICIPATED AN**  
5 **INCREASED CHANCE OF A PROLONGED SERVICE DISRUPTION IN**  
6 **2005?**

7 A. No. In addition to the observations offered by SPS witnesses, I think it was  
8 reasonable for SPS to plan its inventory and coal burn based on the assumption  
9 that there would not be any significant disruptions in service.

10 **Q. WHY DID NO COAL FIRED PLANTS RUN OUT OF COAL DURING**  
11 **THE 2005 SERVICE DISRUPTION?**

12 A. No plants ran out of coal because they curtailed usage by instituting measures to  
13 conserve PRB coal or switch to alternate sources of coal or fuels. Without some  
14 type of conservation plan, some plants would have run out of coal.

15 **Q. WHAT WAS SPS'S BELIEF REGARDING ITS COAL INVENTORY**  
16 **DURING THE 2005 RAIL SERVICE DISRUPTION?**

17 A. [REDACTED]  
18 [REDACTED]  
19 [REDACTED]  
20 [REDACTED].<sup>27</sup>

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<sup>27</sup> See Exhibit AXM10-21 (CONF), pages 25 and 26.



1 **Q. WHAT IS YOUR POSITION REGARDING WHETHER OR NOT SPS**  
2 **NEEDED TO INSTITUTE A COAL CONSERVATION PROGRAM?**

3 A. The coal conservation plan instituted by SPS was necessary and was prudent  
4 given the situation that SPS was facing. BNSF and UP began a maintenance  
5 program on the joint line that was expected to last at least through November, but  
6 there was uncertainty as to the completion of the maintenance project.<sup>28,29</sup>  
7 While BNSF lifted its Force Majeure on June 3, 2005, UP did not lift its Force  
8 Majeure until November 2005 and stated “we strongly encourage each of you [UP  
9 customers of PRB coal] to take steps to conserve coal until normal operations  
10 resume on the joint line.”<sup>30</sup> Although this statement was not made by BNSF, it  
11 was prudent for SPS to listen to the other owner of the joint line.

12 SPS needed to be and was proactive in its thinking and actions that led to  
13 the institution of the coal conservation plan. It is common practice for a utility to  
14 manage the deliveries of coal it receives from the railroads and to take steps that  
15 maximize low cost generation. Attachment TDC-R5 to my testimony contains a  
16 list of 29 other utility companies beyond SPS that were adversely impacted, at  
17 least in part, by the railroads inability to meet their service requirements.<sup>31</sup> Many  
18 of these utilities indicated a need to reduce coal fired generation to manage their

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<sup>28</sup> “Another PRB train derails; joint line repairs to affect traffic for the rest of the year”, July 6, 2005, Platts Coal Trader.

<sup>29</sup> “Getting Up to Speed” July 4, 2005, Traffic World.

<sup>30</sup> “Another PRB train derails; joint line repairs to affect traffic for the rest of the year”, July 6, 2005, Platts Coal Trader.

<sup>31</sup> The list contained in Attachment TDC-R5 is by no means exhaustive, and is based on utilities that have publicly commented upon the impact of the railroads’ service disruption.

1 coal inventories in addition to other mitigation activities such as purchasing coal  
2 from other regions or countries or utilizing higher priced natural gas.

3 **A. ADEQUACY AND ACCURACY OF SPS'S INVENTORY LEVELS**

4 **Q. MR. SCHWARTZ CLAIMS THAT THE TARGET INVENTORY LEVELS**  
5 **AT THE SPS PLANTS ARE TOO LOW, AND SHOULD BE INCREASED**  
6 **TO 45-50 DAYS FROM THEIR CURRENT LEVEL OF 35 DAYS. IS MR.**  
7 **SCHWARTZ CLAIM CORRECT?**

8 A. Based on evidence filed by the OPC and PUCT staff in prior cases and PUCT  
9 decisions, I believe that Mr. Schwartz's claim has already been entertained and  
10 disregarded by PUCT staff.

11 In Docket No. 29801, SPS requested an increase in the coal inventory  
12 target to levels similar to those suggested by Mr. Schwartz:

13 "...SPS asserts that these inventory targets should be increased by ten  
14 additional burn days at each plant for future periods." (Docket No. 29801,  
15 Direct Testimony of Barry Johnson, SPS, page 29 – 5/28/04).

16 In response to SPS's request for higher inventory levels, Mr. Almon, on  
17 behalf of the PUCT, and Ms. Pitchford, on behalf of the OPC, both took the  
18 position that an increase in inventory targets at the SPS was not needed.

19 Specifically, Ms. Pitchford stated:

20 "I conclude that SPS has not demonstrated a particular need to increase the  
21 coal stockpile at this time and that the stockpile target inventory in Docket  
22 19512 not be changed at this time."  
23

24 "SPS has based its assertion that coal stockpile inventory targets be  
25 increased by ten days on general coal and coal transportation information  
26 only. For example, SPS discusses how ratable delivery forces utilities to  
27 take more swing through the use of inventories. Yet it has not presented  
28

1 any evidence that ratable delivery has had a negative effect on the coal  
2 stockpiles that TUCO, its coal supplier, maintains at each of its two coal  
3 plants.” (Docket No. 29801, Direct Testimony of Eileen Pitchford, OPC,  
4 page 7 and page 23 – 10/26/04) (footnote omitted).  
5

6 In response to the question why does SPS believed the coal inventory  
7 target should be adjusted, Mr. Almon of the PUCT stated:

8 “SPS believes that changes in the coal market since 1999 will result in a  
9 strain on the capability of the Union Pacific Railroad (UP) and Burlington  
10 Northern Santa Fe Railroad (BNSF) to meet the needs of customers and  
11 coal deliveries are now “(sic) ratably: throughout the year. SPS suggests  
12 there are three pertinent market changes:  
13

- 14 1. there is expanded demand for steam coal as the result of increased  
15 gas prices;
- 16 2. coal-fired generating unit capacity factors have increased; and
- 17 3. new coal-fired units are being announced”. (Docket No. 29801,  
18 Direct Testimony of T. Brian Almon, PUCT, page 7 – 11/02/04)  
19 (footnote omitted).  
20

21 Mr. Almon goes on to state that:

22 “...even though the coal market is changing, SPS has not persuasively  
23 established a need to increase the target inventory levels. The railroads  
24 are in the business to move coal from the mines to the consumers, and I  
25 conclude they will take the appropriate action to meet the growing demand  
26 for Powder River Basin coal. I conclude that a 35-day inventory level is  
27 sufficient to handle unforeseen events which may delay or temporarily  
28 stop the movement of coal to the Harrington or Tolk stations.” (Docket  
29 No. 29801, Direct Testimony of T. Brian Almon, PUCT, page 9-10 –  
30 11/02/04)  
31

32 Despite SPS’s efforts, both the OPC and the PUCT staff opposed the  
33 increase in the coal inventory target levels. Ultimately, SPS withdrew its request,  
34 and the PUCT never ruled on the issue. Given the hesitance of the OPC and the

1 PUCT to raise inventory targets just a few years ago, I do not foresee them now  
2 acquiescing to higher inventory targets.

3 **Q. MR. CARDWELL ASSERTS THAT SPS WOULD NOT HAVE HAD TO**  
4 **BEGIN FUEL CONSERVATION MEASURES IF IT HAD AN**  
5 **ACCURATE MEASURE OF ITS COAL INVENTORY. IN YOUR**  
6 **OPINION, DID THE DIFFERENCE BETWEEN THE ACCOUNTING**  
7 **AND PHYSICAL INVENTORY OF COAL AT SPS'S PLANTS AFFECT**  
8 **ITS ACTIONS?**

9 A. In my opinion, the difference in inventory levels does not matter in the decision  
10 making process. SPS still faced the possibility of running critically short of coal,  
11 or running out of coal, if the service crisis continued and it did not mitigate its  
12 coal use. Exhibit AXM10-21 (CONF) displays an analysis prepared by SPS at the  
13 beginning of the service crisis. It shows that, based on the information available  
14 at the time, SPS believed it would [REDACTED]  
15 [REDACTED] if it did not institute coal conservation measures.

16 **Q. HOW DOES MR. CARDWELL'S CLAIMS THAT INVENTORY**  
17 **ACTUALLY INCREASED DURING THE COAL CONSERVATION**  
18 **PERIOD IMPACT YOUR THOUGHTS ON SPS'S ACTIONS?**

19 A. Mr. Cardwell's claims lead me to believe that SPS's actions towards conserving  
20 coal were successful.

21 During the course of business prior to the service disruption in May 2005,  
22 BNSF's deliveries [REDACTED]

1 [REDACTED]. Moreover, through the end of June, 2005,  
2 BNSF failed to deliver [REDACTED] tons that were nominated for the first half of the  
3 year.<sup>32</sup> Therefore, inventory levels were below where SPS/TUCO desired before  
4 the service disruption. Also SPS noted that, during the conservation period in  
5 [REDACTED].<sup>33</sup> BNSF's  
6 loading performance<sup>34</sup> versus nominated tons ranged from [REDACTED]  
7 [REDACTED]  
8 [REDACTED] made it nearly impossible to accurately forecast available coal  
9 inventories. Even with these large variances in weekly coal deliveries, SPS found  
10 that total deliveries for the month [REDACTED] given initial  
11 reports of expected rail service.<sup>35</sup> [REDACTED] deliveries of coal,  
12 combined with SPS's coal conservation efforts, lead to a slight increase in  
13 inventory levels for the month. It must be remembered though that the most  
14 important fact is that SPS was attempting to conserve coal. So while conserving  
15 coal, one's goal is to, at a minimum, maintain inventory levels and hopefully  
16 increase them, which SPS was successful at doing.

17 **Q. MR. CARDWELL ASSERTS THAT SPS'S ACTIONS OF PURCHASING**  
18 **COAL FROM NORTHERN PRB MINES AND THEN NOT USING IT**  
19 **FURTHER ILLUSTRATES SPS HAD SUFFICIENT COAL ON HAND TO**

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<sup>32</sup> See Cardwell Exhibit 5, Exhibit AXM10-21(CONF), Page 14.  
<sup>33</sup> See Cardwell Exhibit 5, Exhibit AXM10-21(CONF), Page 16.  
<sup>34</sup> Exhibit AXM10-21(CONF), page 14.  
<sup>35</sup> See Cardwell Exhibit 5, Exhibit AXM10-21(CONF), Page 16.

1           **FOREGO COAL CONSERVATION. DO YOU AGREE WITH MR.**  
2           **CARDWELL’S ASSERTION?**

3    A.    No, I do not. Mr. Cardwell is misleading in his testimony. Mr. Cardwell  
4           discusses the 300,000 tons that SPS bought from Buckskin of which 100,540 tons  
5           were resold but he fails to point out that SPS also purchased 153,444 tons from  
6           Dairyland. Mr. Caldwell states that SPS “waited” until July 21, 2005<sup>36</sup> to  
7           purchase the coal from Buckskin but fails to make the connection that SPS had  
8           already bought coal from Dairyland at the beginning of July. SPS received  
9           122,454 tons in July and 123,372 tons in August from Buckskin and Dairyland  
10          combined.<sup>37</sup> SPS clearly took into account how much tonnage it was receiving  
11          from both Buckskin and Dairyland and not from only Buckskin as Mr. Cardwell  
12          would lead you to believe.

13                 After comparing Mr. Caldwell’s misleading statements to the facts, it is  
14                 evident that SPS used a majority of the coal it received during the conservation  
15                 period. The remaining coal that was resold back into the market does not indicate  
16                 that SPS had sufficient coal on hand to forego coal conservation. At the time that  
17                 SPS made the decision to conserve coal, it was the prudent course of action.  
18                 After the decision was made to conserve, a combination of factors, as discussed  
19                 above, including the greater than anticipated deliveries by BNSF from the  
20                 southern PRB, led SPS to not requiring the remainder of tons provided under the

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<sup>36</sup>         SPS reached an agreement to purchase Buckskin coal in early July, 2005 although the final  
            agreement was not signed until July 21, 2005.

<sup>37</sup>         See SPS Response to Staff RFI BA-22-16.

1 Buckskin contract. In other words, SPS/TUCO diverted trains back to Black  
2 Thunder service when it was feasible to get that coal. So in another prudent  
3 course of action, SPS resold the coal back into the market.<sup>38</sup>

4 **Q. MR. CARDWELL INDICATES THAT BNSF STATED THAT THE**  
5 **SERVICE ISSUES IN THE PRB WOULD NOT HAVE SIGNIFICANT**  
6 **IMPACTS ON BNSF'S 2005 COAL DELIVERIES. WOULD YOU AGREE**  
7 **WITH THIS STATEMENT?**

8 A. I believe that at the very initial stages of the service disruption, right after the two  
9 train derailments, BNSF may not have believed that 2005 coal deliveries would  
10 be impacted, but as the magnitude of the situation became apparent, the railroads,  
11 and the coal industry as a whole, recognized that coal shipments would be  
12 impacted. This is clearly recognized when SPS reported that in private  
13 conversations with the UP, the railroad stated that it and the BNSF were  
14 delivering less than 90 percent of their coal requirements.<sup>39</sup>

15 **Q. MR. CARDWELL IMPLIES AT PAGE 20 OF HIS DIRECT TESTIMONY**  
16 **THAT BECAUSE NO UTILITIES RAN OUT OF COAL DURING AND**  
17 **AFTER THE RAIL PROBLEMS IN THE PRB THAT THE SERVICE**  
18 **DISRUPTION DID NOT CREATE A CRITICAL COAL SUPPLY**  
19 **SITUATION FOR UTILITIES. IN YOUR VIEW, IS HIS ASSERTION**  
20 **CORRECT?**

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<sup>38</sup> PUCT Director of Electric Transmission Oversight T. Brian Almon concurs that SPS/TUCO's selling of the Buckskin coal was not an imprudent action. See Almon Direct Testimony at 16.

<sup>39</sup> See SPS Exhibit AXM10-21, Page 47.

1 A. No. Mr. Cardwell's assertion is not correct because he is confusing cause and  
2 effect. The fact that no coal-fired generation plant ran out of coal is not an  
3 indication of the severity of the service disruption, but an indication of how  
4 utilities managed the disruption in rail service. The reason many utilities did not  
5 run out of coal is that these utilities, like SPS, began coal conservation programs  
6 to mitigate the impact of the rail service disruptions. This fact is supported by an  
7 analysis performed by Mr. Schwartz's firm, and included as Deposition Exhibit  
8 8A to Mr. Schwartz's Deposition in this case. As Mr. Schwartz's firm found,  
9 utility stockpiles fell to critically low levels during the service disruption, and  
10 many rail customers reduced PRB coal-fired generation to conserve coal for peak  
11 periods. Thus, utilities did not run out of coal because of adequate fuel supply or  
12 rail service, but because of mitigation efforts to conserve coal.

13 **Q. IS MR. CARDWELL'S CLAIM ABOUT RAILROADS MANAGING**  
14 **DELIVERIES DURING SHORTAGES OR SERVICE DISRUPTIONS TO**  
15 **ENSURE THAT GENERATING STATIONS WILL NOT RUN OUT OF**  
16 **COAL INCORRECT?**

17 A. Yes, in my opinion, Mr. Cardwell's claim is incorrect. It is the utilities that  
18 manage the delivery of coal and use of coal at a generating station, and not the  
19 serving railroad or railroads. It is my experience that utilities work closely with  
20 railroads to provide timely information regarding train locations and delivery  
21 times, and will prioritize delivery options, but it is the utility that ultimately  
22 manages the coal, not the railroad.



1 **Q. WHAT THEN DO YOU MAKE OF MR. CARDWELL CONCLUDING**  
2 **STATEMENTS THAT SPS COULD HAVE WAITED LONGER TO**  
3 **INITIATE ITS COAL CONSERVATION PLAN?**

4 A. I would state that Mr. Cardwell's statements are nothing more than "Monday  
5 Morning Quarterbacking." In reality, SPS faced a host of facts that it could not  
6 ignore and required action:

- 7 • BNSF had begun significantly curtailing its service to the SPS plants  
8 transporting [REDACTED] percent of the plant requirements.
- 9 • The length of the rail service curtailment was unknown with contradictory  
10 estimates being made by UP and BNSF of the length of time necessary to  
11 cure the maintenance problems.
- 12 • BNSF was parking unit trains in an attempt to reduce congestion and  
13 speed deliveries it could make. One of the unit trains idled belonged to  
14 SPS.
- 15 • SPS was entering into its peak summer months and required as much fuel  
16 as possible to meet its expected needs.
- 17 • SPS's coal supplier had begun shipping it low Btu substitute coal that only  
18 served to effectively reduce SPS's ability to produce electricity.
- 19
- 20
- 21
- 22
- 23

1 In addition, two other witnesses in this proceeding, Messrs. Schwartz and  
2 Falkenberg, support SPS's belief that the company was facing a potentially major  
3 coal supply issue due to BNSF's service slowdown. At Page 29 of his Direct  
4 Testimony, Mr. Schwartz states that SPS reduced coal-fired generation "in  
5 response to a delivery slow down by the BNSF railroad."<sup>40</sup> Mr. Falkenberg went  
6 into a deeper explanation of the problems faced by utilities, including SPS, due to  
7 the railroad's unforeseen service issues:

8 Currently many utilities are  
9 experiencing Power River Basin coal  
10 delivery disruptions due to problems with the  
11 Union Pacific and Burlington Northern &  
12 Santa Fe railroads. In fact, at least 20  
13 utilities have reported delivery problems.  
14 This [Joint] Line is used to transport a  
15 substantial portion of the PRB [coal] used by  
16 utilities in the United States.<sup>41</sup>  
17

18 In hindsight, it is possible to plot a different course of action given what is  
19 now known. However, *ex post* analyses are always much more straightforward  
20 than *ex ante* assessments. Given the limited amount of information possessed by  
21 SPS at the time, I believed SPS acted in a prudent manner in implementing fuel  
22 conservation.

23 **Q. HOW DO YOU REACT TO MR. FALKENBERG'S ASSESSMENT OF**  
24 **SPS'S EFFORTS TO INCREASE COAL INVENTORY?**

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<sup>40</sup> See Schwartz Direct Testimony at 29, Line 19.

<sup>41</sup> See Falkenberg Direct Testimony at 9, Lines 14 to 18. Mr. Falkenberg's statement is consistent with the list of utilities contained in my Attachment TDC-R5.

1 A. Mr. Falkenberg states on page 18 of his direct testimony that SPS “recognized at  
2 the time the risks posed by the PRB coal delivery system and requested an  
3 increase in the inventory levels” from the PUCT. He goes on to explain that the  
4 OPC had previously suggested that the PUCT would only allow an increase in  
5 coal inventory if they provide the “Commission with clear and convincing  
6 evidence that the increase in size was necessary to provide reliable electric service  
7 to its customers.” If SPS could have forecasted such a dramatic decrease in  
8 service from the railroads then they could have provided “clear and convincing  
9 evidence” that an increase in coal inventory was necessary. The fact of the matter  
10 is that BNSF’s service crisis was unpredictable. As I stated above, hindsight is  
11 always clearer than forward-looking assessments.

12 **Q. MR. ALMON OF THE PUCT STAFF ALSO STATES AT PAGES 5 AND**  
13 **10 OF HIS DIRECT TESTIMONY THAT SPS WAS IMPRUDENT IN THE**  
14 **HANDLING OF ITS COAL INVENTORY LEADING TO ADDITIONAL**  
15 **FUEL COSTS. WHAT IS THE BASIS OF HIS CLAIM?**

16 A. At page 10 of his direct testimony, Mr. Almon indicates that the additional costs  
17 were due to three primary factors impacting SPS coal inventory. First, SPS should  
18 have realized in 2004 that coal deliveries were not at a level to maintain the target  
19 inventory at each plant and taken action with the BNSF to address the issue.  
20 Second, that SPS should have more closely considered the timing of its physical  
21 inventories to have the most up to date information available about its actual

1 inventory levels. Third, SPS should have accepted all the spot coal it purchased in  
2 2005 to assure stockpiles moved closer to their target levels.

3 **Q. DO YOU AGREE WITH MR. ALMON'S CLAIM THAT SPS WAS**  
4 **IMPRUDENT?**

5 A. No. I believe Mr. Almon's claim of imprudence is incorrect. I think Mr. Almon  
6 did not consider information provided by SPS. In late 2004, SPS acknowledged  
7 the delivery issues and had taken steps to solve the issue. I believe that Mr.  
8 Almon's issues with the physical inventory overlook the fact that even if SPS had  
9 known the exact amount of its physical inventory going into its fuel conservation  
10 efforts, SPS would still have been prudent to implement a fuel conservation  
11 program because of the uncertain future concerning BNSF's ability to deliver  
12 coal. Finally, Mr. Almon's belief that SPS should have accepted all of its spot  
13 coal purchases in 2005 is based on the faulty assumption that the spot coal was an  
14 addition to, and not a replacement for, its normal coal deliveries from the Black  
15 Thunder mine. Stated differently, Mr. Almon failed to recognize that SPS did not  
16 have the equipment to move both spot coal and the contract Black Thunder coal.

17 **Q. MR. ALMON'S FIRST ISSUE DEALS WITH 2004 COAL DELIVERIES**  
18 **BY BNSF LEADING TO LOWER INVENTORY LEVELS. WHAT IS THE**  
19 **BASIS FOR HIS CONTENTION?**

20 A. Mr. Almon states at page 11 of his testimony that SPS indicated that its inventory  
21 levels were lower than planned primarily due to rail delivery problems. One  
22 factor that Mr. Almon contributed to the low inventory levels at the SPS stations

1 was higher than historical railroad cycle times to the SPS stations. Mr. Almon  
2 performed an analysis that compared BNSF's cycle times from 2002 to 2005. He  
3 states that average cycle times to Harrington for the last four months of 2004 were  
4 approximately 7 percent higher than 2002 and 2003 average cycle times, and that  
5 average cycle times to Tolk for the last 4 months of 2004 were approximately 10  
6 percent higher than 2002 and 2003 average cycle times. Mr. Almon also claims  
7 that there was an upward trend in the cycle times between the beginning of 2004  
8 and the end of 2005.

9 **Q. ARE MR. ALMON'S CYCLE TIME CALCULATIONS ACCURATE?**

10 A. Mr. Almon's calculations of the cycle time averages are accurate, but the  
11 conclusions he draws from the calculations are irrelevant. For example, SPS  
12 already acknowledged and understood that BNSF's cycle times were higher than  
13 in the past. Mr. Almon acknowledged that SPS understood this was leading to  
14 lower than planned inventory levels. Also, his conclusion that there was an  
15 upward trend in cycle times between the beginning of 2004 and the end of 2005 is  
16 to be expected because it encompasses the timing of the 2005 rail service  
17 disruption. In other words, it just confirms one of SPS's reasons for starting its  
18 coal conversation program.

19 **Q. DOES MR. ALMON HAVE ANY OTHER ISSUES REGARDING THE**  
20 **INCREASE IN RAILROAD CYCLE TIMES?**

21 A. At page 12 of his testimony, Mr. Almon states the primary problem was that,  
22 even knowing BNSF's cycle times were increasing, he could not find any

1           indication that SPS took any action in late 2004 to increase the amount of tons  
2           delivered to the power plants.

3   **Q.    IS MR. ALMON’S CLAIM THAT SPS TOOK NO ACTION CORRECT?**

4   A.   No. His claim is incorrect. SPS did take actions to increase BNSF’s coal  
5           deliveries. For example, page 24 of Exhibit AXM10-21(CONF) contains a  
6           summary of SPS’s actions and findings around the events leading up to its coal  
7           conservation actions at Harrington and Tolk. The summary discusses [REDACTED]

8           [REDACTED]

9           [REDACTED]

10          [REDACTED]

11          [REDACTED]

12          [REDACTED]

13          [REDACTED]

14          [REDACTED].

15   **Q.    MR. ALMON, AT PAGES 13 AND 14 OF HIS DIRECT TESTIMONY,**  
16           **IMPLIES THAT SPS WOULD NOT HAVE HAD TO IMPLEMENT COAL**  
17           **CONSERVATION IF IT HAD KNOWN IT HAD BETTER**  
18           **INFORMATION ABOUT ITS PHYSICAL INVENTORY. DO YOU**  
19           **AGREE WITH HIS CONTENTION?**

20   A.   No. Mr. Almon’s contention is predicated on the assumption that if SPS had  
21           known its physical inventory positions in July 2005, it would not have  
22           implemented fuel conservation at the SPS stations. As I described in detail

1 above, this belief is really a red herring. In July 2005, SPS/TUCO did not know  
2 how long the PRB service problems would last. Even if SPS knew that its  
3 physical inventory position going into the service disruption was greater than it  
4 thought, it still would have been prudent to implement coal conservation given  
5 the projected end of year inventory levels without conservation. As I stated above  
6 in discussing Mr. Cardwell's contention on this same matter, it is always easier to  
7 make these claims in hind-sight, as opposed to making the decisions during the  
8 middle of an active disruption.

9 **Q. WHAT ABOUT MR. ALMON'S FINAL CLAIM THAT SPS SHOULD**  
10 **HAVE ACCEPTED ALL OF THE SPOT COAL IT PURCHASED IN 2005**  
11 **TO HELP INCREASE ITS YEAR END INVENTORY LEVELS. IS HE**  
12 **CORRECT?**

13 A. No, this claim is also incorrect because it is based on the faulty assumption that  
14 the spot coal purchased by SPS/TUCO in 2005 was purchased as an addition to  
15 the coal purchased under the Arch contracts and not a replacement for the Arch  
16 supplied coal. This was made clear in an August 5, 2005 e-mail from SPS's  
17 David Hudson to Mr. Almon. As Mr. Hudson stated in his e-mail to Mr. Almon:

18 One other aspect of the mitigation plan was to  
19 investigate the possibility of TUCO purchasing  
20 some coal from mines in the northern part of the  
21 PRB, thus avoiding the areas that would be most  
22 congested due [to] track maintenance. TUCO was  
23 able to purchase some tonnage from two mines in  
24 the northern PRB.<sup>42</sup> (*Emphasis Added*)  
25

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<sup>42</sup> See Exhibit AXM10-21 at page 14.

1           It is clear from Mr. Hudson's e-mail that SPS intended to purchase the  
2 spot coal instead of receiving the Arch coal, which was sourced from mines in the  
3 middle of the track maintenance zone. SPS also made this point clear in the many  
4 public statements that it made about its actions during the coal conservation  
5 period.<sup>43</sup>

6 **Q.   WHY THEN DID SPS NOT TAKE BOTH THE ARCH COAL AND ALL**  
7 **OF THE SPOT COAL IF IT WOULD HELP TO INCREASE INVENTORY**  
8 **LEVELS?**

9 A.   SPS did not have the equipment available to move both the Arch coal and the spot  
10 coal. Both spot purchase contracts show that delivery point for the spot coal was  
11 FOB railcar at the mine, meaning that SPS/TUCO was responsible for the  
12 transportation from the mine to the SPS plants.<sup>44</sup> This would mean that to  
13 transport the coal from the spot purchases, SPS/TUCO would either have to divert  
14 a train set which was moving coal from the Black Thunder Mine, or find another  
15 train set to move the coal. The market for short-term leases of train sets during  
16 the service disruption was very tight, and I do not believe that TUCO could have  
17 found the additional equipment to transport the spot coal and the Arch coal.

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<sup>43</sup> See for example Exhibit AXM10-21 at page 2.

<sup>44</sup> See Exhibit AXM10-36 at pages 1 and 4.



1 Further, TUCO was advised by BNSF that even should TUCO locate an  
2 additional train set, that BNSF would not allow TUCO to place the set in service  
3 during the disruption. In the end, SPS/TUCO had to make a decision to either  
4 ship Black Thunder coal or coal from its spot purchases. Since the Black Thunder  
5 coal has a higher average Btu content than either of the spot coals (8,800 Btu coal  
6 vs. 8,550 and 8,400 Btu coal), I believe SPS/TUCO made the correct decision to  
7 transport the Black Thunder coal, but either way, it would not have impacted its  
8 inventory situation.

9 **B. RESPONSIBILITY FOR THE COST OF COAL CONSERVATION**

10 **Q. MR. FALKENBERG ASSERTS THAT SPS IS RESPONSIBLE FOR \$7.6**  
11 **MILLION IN ADDITIONAL FUEL EXPENSES. IS MR.**  
12 **FALKENBERG’S CLAIM VALID?**

13 A. No, Mr. Falkenberg states on page 7, Line 9 of his direct testimony that the \$7.6  
14 million represents additional costs in Eligible Fuel Expense (“EFE”) stemming  
15 from the failure of the BNSF to perform its contractual obligations resulting in a  
16 shortage of PRB coal. Mr. Falkenberg also states that the \$7.6 million is  
17 “presented on a Texas jurisdictional basis without interest.” While he does not  
18 provide specific support for his calculation, it appears from his Exhibit RJF-4 that  
19 the basis for his figure is SPS’s response to RFI OPC8-17 which indicated that  
20 SPS incurred additional generation costs of approximately \$15.5 million during  
21 SPS’s coal conservation efforts in 2005. Because the additional costs SPS

1 incurred were, in my opinion, prudent given the circumstances at the time, Mr.  
2 Falkenberg's position that SPS is responsible for the additional costs is invalid.

3 **Q. ON PAGE 11 OF HIS TESTIMONY, MR. FALKENBERG STATES THAT**  
4 **SPS HAS AN OBLIGATION TO PROVE THE PRUDENCE OF**  
5 **ADDITIONAL COSTS, WHETHER CAUSED BY SPS OR ONE OF ITS**  
6 **SUPPLIERS, BECAUSE ONLY PRUDENT COSTS CAN BE INCLUDED**  
7 **IN THE EFE. IS MR. FALKENBERG CORRECT?**

8 A. Mr. Falkenberg's position on this issue is self-contradictory. On the one hand, he  
9 believes that SPS must assess the prudence of all parties before the coal disruption  
10 costs can be included in the EFE. On the other hand, Mr. Falkenberg states on  
11 page 15, lines 21 and 22 that, "Consequently, the Commission should not expect  
12 SPS to provide evidence concerning the prudence of the third parties." By this  
13 logic, SPS would never be able to include these costs in the EFE because it would  
14 be required to assess the prudence of all parties first, but then would not be  
15 permitted to perform this type of assessment.

16 **Q. ON PAGE 11 OF HIS TESTIMONY, MR. FALKENBERG STATES THAT**  
17 **AS A MATTER OF REGULATORY POLICY, COMMISSIONS HAVE**  
18 **HELD THAT UTILITIES ARE RESPONSIBLE FOR THE FAILURE TO**  
19 **PERFORM BY THIRD PARTIES. DO YOU AGREE THAT THIS IS A**  
20 **VALID ARGUMENT?**

21 A. No. A review of his testimony provides no indication that the failure of a railroad  
22 to provide contracted amounts of coal is analogous to the cases that he cites.

1 **Q. PLEASE GIVE AN EXAMPLE.**

2 A. Mr. Falkenberg quotes the *Application of Texas Utilities Electric Company, Inc.,*  
3 *To Reconcile Its Fuel Costs*, PUCT Docket No. 15195, in which a chimney  
4 collapsed while a contractor was attempting to clean it. The accident caused  
5 Texas Utilities Electric Company's ("TUEC") Moses Unit No. 3 to be closed for  
6 19 months. The Commission found that TUEC was responsible for the resulting  
7 lost economic benefit because, "By virtue of the fact that they paid TUEC's base  
8 rate costs during the reconciliation period, TUEC's ratepayers are entitled to a  
9 reasonable level of performance from the resources that gave rise to those base  
10 rate costs." However, the current situation involves assets that are not owned or  
11 controlled by SPS and are not in the company's rate base. The assets are owned  
12 by BNSF and UP, and SPS ratepayers do not have the same type of claim to usage  
13 of these assets.

14 **Q. HOW ELSE ARE MR. FALKENBERG'S ANALOGIES INAPPLICABLE?**

15 A. The relationship between SPS/TUCO and the railroads that deliver coal from the  
16 PRB are completely different from the other utility/vendor relationships that Mr.  
17 Falkenberg mentions. For example, Mr. Falkenberg cites to several cases heard  
18 before the PUCT and a case from the Oregon Public Utility Commission whereby  
19 vendors supplied faulty equipment that was used directly in the generating  
20 stations. In each of the cases, Gulf State Utilities (PUCT Docket No. 7195),  
21 TXU (PUCT Docket Nos. 9300 and 11735), South Texas Project (PUCT Docket  
22 Nos. 8425 and 6668) and Pacific Gas and Electric (UE-88) in Oregon), the vendor

1 was responsible for providing faulty equipment ultimately installed and used in  
2 the generating station. Because the vendors in the cases cited by Mr. Falkenberg  
3 were effectively latching apparatus to the generating station that directly impacted  
4 their operation, it was reasonable for the utilities to be held accountable for the  
5 supervision and overview of their installation and operation. In this instance  
6 though, SPS has no control over BNSF or how the railroad maintains its track or  
7 operates its trains in the PRB. More importantly, SPS had no control over the  
8 maintenance issues leading to the rail disruption.

9 In an additional example, Mr. Falkenberg quotes *Entergy Gulf States, Inc.*  
10 *v. Louisiana Public Service Commission et al.*, 726 So.2d 870, 883 (La. 1999)  
11 where the commission states that, “Therefore, as between GSU and the  
12 ratepayers, GSU alone is in a position to select the vendors and control their  
13 conduct.” In the case of PRB transportation, Tolk is captive to the BNSF. No  
14 economically reasonable alternate transportation option exists for carrying coal  
15 from the PRB to the station. Harrington, on the other hand, has access to both the  
16 UP and BNSF railroads, but faces an effective duopoly from these railroads. The  
17 line where the coal disruptions occurred is co-owned and operated by these two  
18 railroads. Both Tolk and Harrington are currently designed to burn PRB coal.<sup>45</sup>  
19 SPS cannot simply select a new vendor as could the utilities in the cases cited by  
20 Mr. Falkenberg.

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<sup>45</sup> See SPS’s response to AXM’s RFI 10-40, Exhibit 10-41.

1           Finally, Mr. Falkenberg puts forth an example of a case before the  
2 Wyoming Public Service Commission (“WPSC”) where PacifiCorp allegedly was  
3 unable to recover excessive costs due to the fraudulent actions of Enron. The  
4 issue involved in the Wyoming case in which Mr., Falkenberg alludes to is  
5 completely different than the issues involved in this case making Mr.  
6 Falkenberg’s analogy completely irrelevant. In the Wyoming case, PacifiCorp  
7 was seeking authority to increase its retail electric utility service rates.  
8 Interveners in the case argued that spot power purchases PacifiCorp made in 2001  
9 from Enron were above then current market rates, and PacifiCorp should not be  
10 allowed to recover the higher than market costs in future rates because the issue  
11 costs were not recurring.<sup>46</sup> The WPSC agreed with the interveners that the costs  
12 should be excluded, but not for the reasons cited by Mr. Falkenberg. The WPSC  
13 disallowed the above market expenses incurred by PacifiCorp because they were  
14 not ongoing and should not have an effect on future rates.<sup>47</sup> The WPSC’s  
15 decision is in contrast to Mr. Falkenberg’s contention that the utility was held  
16 accountable for the imprudent actions of a third-party supplier.<sup>48</sup>

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<sup>46</sup> Final Order in Docket No. 20000-ER-02-184, Paragraph 250.

<sup>47</sup> Final Order in Docket No. 20000-ER-02-184, Paragraph 265.

<sup>48</sup> In addition, Mr. Falkenberg infers that the impact of the WPSC’s decision disallowing the recovery of the costs associated with the Enron power purchases totaled approximately \$60 million. See Falkenberg Direct Testimony at Page 15, Line 13. In actuality, the \$60 million cited by Mr. Falkenberg was for all deferred power costs addressed by the WPSC. The net impact of the Enron disallowance was only \$1.1 million. See Final Order in Docket No. 20000-ER-02-184, Paragraph 265.

1    **Q.    DO YOU AGREE WITH MR. FALKENBERG’S ASSERTION ON PAGE**  
2           **10 OF HIS DIRECT TESTIMONY THAT THE PUCT SHOULD HOLD**  
3           **UTILITIES ACCOUNTABLE FOR FAILING TO ENSURE ADEQUATE**  
4           **FUEL SUPPLIES TO ECONOMICALLY OPERATE ALL CAPACITY?**

5    A.    I concur that utilities should ensure adequate fuel supply during times of normal  
6           operations, but the time period in question was not in any sense normal. Both  
7           railroads operating over the PRB Joint Line, BNSF and UP, declared Force  
8           Majeure on the Joint Line’s track structure. Subsequent to lifting its force  
9           majeure, the BNSF still was transporting coal at well below 100 percent of its  
10          normal capacity.

11   **Q.    THEREFORE, DO YOU BELIEVE THERE IS A DIFFERENCE**  
12          **BETWEEN REASONABLY FORESEEABLE EVENTS AND**  
13          **UNFORESEEABLE EVENTS?**

14   A.    Absolutely. There are costs associated with planning for either foreseeable or  
15          unforeseeable events. The PUCT Staff recognized the costs of foreseeable events  
16          when SPS sought inventory increases in 1999 to further hedge against these  
17          events. The Staff, however, disagreed with the level of costs related to foreseeable  
18          events that impact coal inventory. Asking utilities to plan for every unforeseen  
19          event in a state nearly one thousand miles away is beyond the pale of  
20          reasonableness. To treat a rail disruption of the magnitude and seriousness of the  
21          PRB rail crisis as if it was an everyday occurrence is not reasonable. SPS could  
22          not be expected to plan its generation demands based on an expectation that

1 BNSF would not deliver the tonnage required to support SPS's expected level of  
2 coal-fired generation.

3 **Q. MR. FALKENBERG, AT PAGE 11 OF HIS DIRECT TESTIMONY,**  
4 **BELIEVES THAT PART OF THE NEED FOR COAL CONSERVATION**  
5 **IN THE SUMMER OF 2005 STEMS FROM THE RELATIONSHIP**  
6 **BETWEEN SPS AND TUCO. SPECIFICALLY, THAT SPS HAS**  
7 **"DELEGATED" FUEL SUPPLY TO TUCO, BUT THEN DOES NOT**  
8 **HOLD TUCO ACCOUNTABLE FOR THE NEED TO CONSERVE FUEL.**  
9 **IS THE RELATIONSHIP BETWEEN TUCO AND SPS THE CAUSE OF**  
10 **THE CURRENT ISSUE?**

11 A. No, I do not believe that the contractual and working relationship between TUCO  
12 and SPS led to the need for coal conservation at the SPS plants, but rather the  
13 unforeseeable events in the PRB lead to the need to conserve coal. TUCO must  
14 work within several constraints that limited its options in providing coal to SPS  
15 during the service disruption. First, Tolk and Harrington are designed to burn  
16 PRB coal.<sup>49</sup> This limits the ability of TUCO to look at other coal basins in which  
17 to diversify coal supply. Second, PRB coal can only be economically delivered to  
18 the SPS stations by rail. Currently, there are only two railroads serving the PRB  
19 mines, UP and BNSF, and these two railroads are the only ones to serve the SPS

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<sup>49</sup> SPS Response to AXM10-41.

1 coal generation plants.<sup>50</sup> Therefore, TUCO was unable to use any alternative  
2 source of transportation to economically deliver coal to SPS. The simple fact is  
3 that whether TUCO supplied the PRB coal to SPS, or if SPS had directly  
4 contracted with the coal producers itself, the flow of coal moving out of the PRB  
5 was severely disrupted during 2005. Pointing fingers at SPS or TUCO as the  
6 culpable party does not refute this fact.

7 **Q. AT PAGE 17 OF HIS DIRECT TESTIMONY, MR. FALKENBERG**  
8 **CONTENDS THAT SOMEONE EITHER SPS, TUCO OR BNSF, MUST**  
9 **BE HELD ACCOUNTABLE FOR COAL SUPPLY AT THE SPS PLANTS,**  
10 **AND FURTHER CONTENDS THAT THAT “SOMEONE” ULTIMATELY**  
11 **MUST BE SPS. DO YOU CONCUR?**

12 A. No, I do not concur with Mr. Falkenberg because there is an economic limit as to  
13 which one can ensure performance and assign accountability. SPS could have  
14 entered into coal supply and coal transportation contracts that guaranteed 100  
15 percent of nominated coal tons would be delivered on time 100 percent of the  
16 time, but the cost of such contracts would have been so prohibitively expensive as  
17 to make it economically unfeasible to operate Tolk and Harrington. Instead, SPS  
18 entered into coal supply and transportation arrangements that allowed for the  
19 economically feasible delivery of coal to the SPS plants, taking into consideration  
20 reasonable and foreseeable disruptions in the coal supply chain. It is just not  
21 rational, from an economic perspective, to hold a party accountable for every

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<sup>50</sup> Harrington is served by both the BNSF and the UP, but Tolk is captive to the BNSF.



- 1 potential event that could lead to increased costs. To do so would impute so
- 2 much cost into transactions to make normal business economically impractical.

1 **V. CONCLUSION**

2

3 **Q. WERE ATTACHMENTS TDC-R1 THROUGH TDC-R5 PREPARED BY**  
4 **YOU OR UNDER YOUR SUPERVISION AND CONTROL?**

5 A. Yes.

6 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

7 A. Yes.



