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June 15, 2010

Anne K. Quinlan, Esq.
Acting Secretary
Surface Transportation Board
395 E Street, SW
Washington, DC 20423

227280

Re: Ex Parte No. 558 (Sub-No. 13)
Railroad Cost of Capital – 2009

Dear Secretary Quinlan:

Attached for filing in the above-referenced proceeding is the Verified Statement of Gerald W. Fauth, III, submitted on behalf of National Grain and Feed Association. Mr. Fauth's recommendations reflect the views of NGFA.

I hereby certify that a copy of the attached Verified Statement of G.W. Fauth, III has been served, this 15th day of June 2010, on all parties of record by first class mail, postage prepaid.

Respectfully submitted,

Andrew P. Goldstein

Andrew P. Goldstein
Attorney for
National Grain and Feed Association

BEFORE THE

U.S. SURFACE TRANSPORTATION BOARD

EX PARTE NO. 558 (SUB-NO. 13),

RAILROAD COST OF CAPITAL - 2009

VERIFIED STATEMENT

OF

GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (GWF), an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. A statement describing my background, qualifications and experience is attached hereto as Appendix GWF-1.

In a decision served March 30, 2010 in Ex Parte No. 558 (Sub-No.13), Railroad Cost of Capital - 2009, the U.S. Surface Transportation Board (STB) instituted a proceeding to determine the railroad industry's cost of capital for 2009, which will be used in the determination of railroad revenue adequacy for 2009 and other purposes. In this decision, the STB seeks comments on five (5) "narrow" issues:

(1) the railroads' 2009 current cost of debt capital;

(2) the railroads' 2009 current cost of preferred equity capital (if any);

(3) the railroads' 2009 cost of common equity capital;

(4) how the change in BNSF Railway Company's (BNSF's) share prices from November 2009 through December 2009, following the announcement of BNSF's acquisition by Berkshire Hathaway Inc. (Berkshire), should be considered in calculating the 2009 cost of common equity capital; and

(5) the 2009 capital structure mix of the railroad industry on a market value basis.

I have been asked by the National Grain and Feed Association (NGFA) to prepare and submit theses comments in response to the STB's decision in this proceeding. I have been asked to focus my comments on the impacts associated with BNSF's acquisition by Berkshire (issue number 4 above).

STB's 2008 and AAR's Proposed
2009 Cost of Capital Calculations

The STB cost of capital calculations are primarily based on submissions by the Association of American Railroads (AAR) concerning the current debt and equity rates and debt/equity mixtures associated with the four (4) largest Class I carriers: BNSF, CSX Corporation (CSX), Norfolk Southern Corporation (NS) and Union Pacific Corporation (UP). The STB's 2008 cost of capital methodology (as set forth in its decision in Ex Parte No. 558 (Sub-No.12), Railroad Cost of Capital – 2008, served September 25, 2009) and AAR's proposed 2009 cost of capital calculations (as set forth in its filing in this proceeding dated May 17, 2010), are summarized in Table 1 below. As can be seen, AAR has projected that the 2009 cost of capital was 10.47%, which would be down from 11.75% in 2008.

Table 1

Item	Rate	Capital Structure Mix	Total
STB's 2008 Cost of Capital Calculation			
2008 Debt	6.57%	21.54%	1.42%
2008 Equity	13.17%	78.46%	10.33%
STB's 2008 After-Tax Cost of Capital			**11.75%**
AAR's Proposed 2009 Cost of Capital Calculation			
2009 Debt	5.72%	29.10%	1.66%
2009 Equity	12.43%	70.90%	8.81%
AAR's Proposed 2009 After-Tax Cost of Capital			**10.47%**

Railroad Submissions

In this proceeding, in addition to AAR's routine annual cost of capital submission, BNSF and Kansas City Southern Railway Company (KCS) filed comments on May 17, 2010. The railroads' (i.e., AAR, BNSF and KCS) collective position concerning the BNSF/Berkshire issue is two-fold: (1) because the BNSF acquisition was not consummated until 2010 and BNSF was publically traded throughout 2009, BNSF "fully satisfied the criteria for inclusion in the railroad sample for the entire 2009 period" and its "common equity should accordingly be considered similarly to that of the other three railroads in the composite railroad sample for purposes of calculating the railroad industry's cost of equity capital for 2009."[1] and; (2) "there is no basis for the Board to make any adjustments for the changes in BNI share price for the period November through December 2009 in calculating the rail industry's cost of common equity for 2009."[2] The railroads' position is perhaps best summarized by BNSF which states that "any proposed modification to exclude or modify BNSF's data from the 2009 railroad sample would be inappropriate and contrary to the Board's rules and prior precedent."[3]

KCS is "fully supportive" of the position that BNSF's data should not be excluded or modified in terms of the 2009 current cost of capital calculation. However, KCS is rightfully concerned about future cost of capital calculations. KCS states that "under the Board's current standards BNSF apparently will not be included in the Board's cost of capital determination in the future."[4] This is because the Board's current criteria includes a provision that at least 50 percent of its holding company's assets must be devoted to railroad operations and BNSF now

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[1] AAR filing dated May 17, 2010, page 2, footnote 2.
[2] Verified Statement of John T. Gray, page 46.
[3] Supplemental Comments of BNSF, dated May 17, 2010, page 3.
[4] Comments of KCS, dated May 17, 2010, page 3.

only represents approximately 18% of Berkshire's assets.[5] KCS maintains that the "time is ripe" for the STB to revisit and reconsider its "criteria utilized for determining which railroad holding companies should constitute the composite railroad."[6] KCS suggests that future cost of capital determinations should be developed using the remaining "six publically traded Class I railroads/railroad holding companies – UPC, CSX, NSC, KCS, CP, & CN," which would *exclude* BNSF.[7] KCS expresses "no opinion whether a methodology could be developed to include BNSF in the calculation."[8]

Berkshire/BNSF
Transaction & Acquisition Premium

On November 3, 2009, Berkshire announced the proposed acquisition of BNSF in a transaction valued at $44 billion. The $44 billion transaction value is comprised of a $34 billion investment in BNSF outstanding shares at $100 per share and the assumption of approximately $10 billion of outstanding BNSF debt.[9] The acquisition, which did not require STB approval, was quickly approved by BNSF's shareholders a few months later on February 11, 2010 and, on February 12, 2010, BNSF officially became a subsidiary of Berkshire.[10]

Berkshire's acquisition price for BNSF was substantially higher than BNSF's pre-announcement market value. This difference is called an "acquisition premium." Acquisition premiums in railroad mergers are defined by the STB as "the difference between the value of a company based upon either the book value or the price of a single share of stock before a tender

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[5] Railroad Cost of Capital – 1984, I.C.C. 2d 989 (1985) and Berkshire 1st Quarter 2010 SEC Report.
[6] Comments of KCS, dated May 17, 2010, pages 3 and 4.
[7] Ibid. page 4 and 5.
[8] Ibid., page 5, footnote 1.
[9] BNSF and Berkshire joint press release dated November 3, 2009.
[10] BNSF press release dated February 11, 2010.

offer and the price that the buyer actually has to pay to obtain control."[11] Under STB's current policy in railroad mergers, whenever assets are sold, the acquisition cost becomes the new book value. An acquisition premium, therefore, results in an increase in the railroads' book value. I am aware of no other regulatory agency that allows this approach.

Berkshire agreed to pay $100 per share for BNSF's outstanding shares and assume approximately $10 billion in BNSF's debt. At closing of the stock market on November 2, 2009, BNSF shares were valued at $76.07 per share. As of November 1, 2009, the BNSF's had 340,522,033 shares of outstanding Common Stock.[12] Thus, BNSF had a market value of approximately $26 billion before the transaction was announced and approximately $34 billion afterward.[13] As a result, the acquisition premium was approximately $18 billion ($44 minus $26 billion) or $8 billion (minus the $10 billion debt), depending upon how BNSF's debt is treated.[14]

Included in AAR's submission is the Verified Statement of John T. Gray, AAR Senior Vice President, Policy and Economics. Witness Gray's Appendix H shows BNSF's market value for the 52 weeks in 2009 and is summarized in the following chart:

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[11] See STB Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures (served June 11, 2001) at p.28).

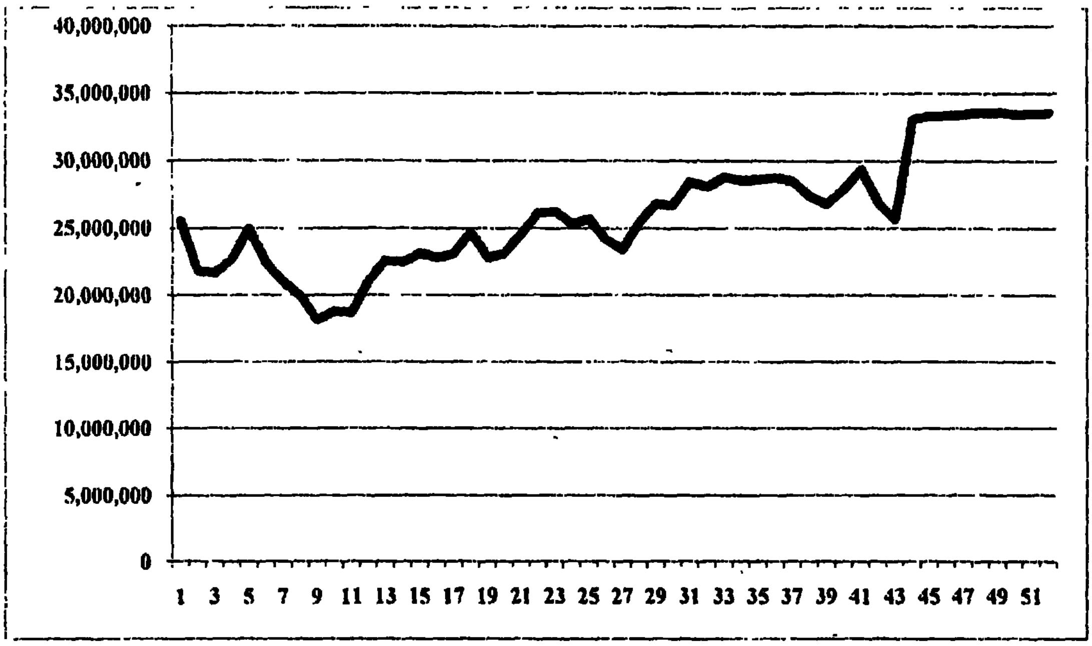
[12] SEC Schedule 13D filing November 2, 2009.

[13] 340,522,033 shares x $76.07 per share = $25,903,511,050.

[14] Berkshire S-4 SEC filing dated November 25, 2009, page 109 lists "Book Value of BNSF net assets acquired September 30, 2009" as $12.225 billion. Under the STB's acquisition premium definition, book value can also be used to determine the acquisition premium. Using the book value approach, the acquisition premium would increase to nearly $32 billion (or nearly $22 billion without the $10 billion in BNSF debt). In addition to assuming BNSF's $10 billion debt, Berkshire has indicated that it will issue another $8 billion in debt in connection with this proceeding (see Berkshire S-4, page 110). This additional $8 billion debt could also end up in BNSF's R-1 Report to the STB.

Chart 1

BNSF's Changes in Market Value During 2009 (000)

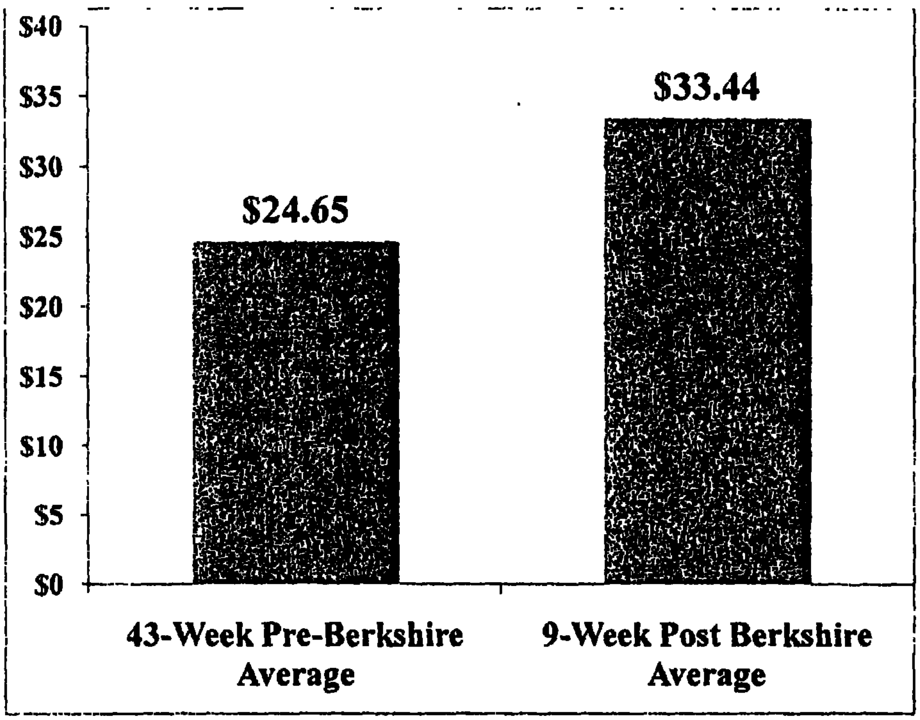


As can be seen, between weeks 43 (10/26/2009) and 44 (11/02/2009), BNSF's market value increased significantly as a result of the Berkshire announcement. Witness Gray has calculated that BNSF's average 2009 market value was $26.17 billion, which is actually lower than BNSF's 2008 market value of $31.63 billion.[15] Witness Gray's Appendix H indicates that the average market value for the 43 weeks prior to the Berkshire announcement was $24.65 billion and $33.44 billion for the 9 weeks after the announcement, which can be seen in the flowing chart:

[15] See decision in Ex parte No. 558 (Sub-No. 12), page 19, Table 13.

Chart 2

Change in BNSF's Average Market Value
Before and After Berkshire Announcement
(Billions)



STB's Prior Treatment of
Railroad Merger Premiums

For many years, the STB (and its predecessor, the ICC) have been confronted with issues surrounding merger and acquisition premiums paid in most of the recent major transactions involving railroads. Shippers have long voiced concerns about the potential adverse impacts associated with such railroad acquisition premiums. In past railroad mergers, however, the STB has allowed the associated acquisition premiums to be built into the railroads' R-1 annual reports submitted to the STB.

The railroads' R-1 data are used by the STB to calculate railroads' return on investment (ROI) and railroad revenue adequacy. The STB's past revenue adequacy calculations show that the ROI's for each of the railroads involved in the most recent mergers significantly dropped in the years following the mergers. These post-merger ROI reductions were caused, in part, by the merger acquisition premiums.

The R-1 data are also used by the STB to develop its Uniform Railroad Costing System (URCS) data for each Class I railroad, which are used to calculate the STB's jurisdictional threshold for rate regulation and other regulatory purposes. Again, STB's URCS data show that the railroads' post-merger URCS costs increased, in part, as a result of the acquisition premiums in railroad mergers.

The ICC and the STB have mostly looked the other way and its policies have only encouraged the payment of such premiums. Many have suggested that the STB should adopt a policy of valuing all properties obtained through a merger based upon the predecessor book values or the stock price of the entity before the merger. However, the STB has refused to adopt such a policy.[16]

The STB's position, in allowing merger and acquisition premiums to be paid (and, in effect, to be passed through to captive customers), has essentially been that any potential adverse impact on rates associated with the acquisition premium will be more than offset by merger synergies and benefits that shippers will receive as a result of the transaction. In every large railroad transaction, the railroads involved have claimed many synergies and other merger benefits (such as elimination of interchange costs, improved crew and equipment utilization, etc.).

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[16] See, for example, STB Ex Parte No. 582 (Sub-1), supra n.3.

Of course, such merger benefits could help offset the post-merger increases in the book values of the assets. In reality, however, past railroad mergers and acquisitions have often led to service failures (unlikely here), higher costs (likely here) and higher rates (likely here). It is obvious that the STB's policy in this regard did not square with the results. Other agencies, such as the Federal Energy Regulatory Commission (FERC), require the merging or acquiring entities to provide certain benefits (such as rate reductions) to obtain approval of any premiums paid, but the STB has never required such benefits.

Berkshire/BNSF
<u>Merger Benefits & Synergies</u>

There is a big difference between previous railroad mergers and the Berkshire/BNSF transaction. Since the Berkshire/BNSF transaction was not a merger between railroads: (1) it did not require STB approval; and (2) there are no transportation synergies and minimal, if any, other merger benefits that could be passed on to shippers which could help offset the acquisition premium. BNSF's officers, directors and stockholders will certainly benefit from the $100 per share transaction, but BNSF's customers will not.[17]

In fact, it appears that nothing will really change at BNSF. BNSF Chief Executive Officer Matt Rose recently said in an interview that Berkshire gives him "free rein" and has said Berkshire instructed him to "just keep doing what you're doing." I suppose this could be seen as a benefit to shippers since no changes will likely mean no service failures. [18]

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[17] A point of disclosure, GWF owned 19 shares of BNSF, which were tendered and sold on 2/17/2010.

[18] Matt Rose interview with Susie Gharib, PBS Nightly Business Report, April 30, 2010.

Moody's (of which Berkshire is a major shareholder) announced that it may upgrade BNSF's rating because of the Berkshire deal.[19] A possible reduction in BNSF's debt rating and future debt costs may impact future cost of capital calculations , but will provide little or no benefit to shippers. In terms of the impact on URCS, any such reduction in BNSF's debt rate is essentially irrelevant since the pre-tax current cost of capital level used by the STB in URCS (currently 17.31%) will always be significantly higher than BNSF's actual debt level.[20]

Moody's press release stated that the deal "gives BNSF the potential to boost investments in its business while maintaining its debt capacity, making for greater competitive edge against other North American railroads." It is possible that the deal may give BNSF "the potential to boost investments in its business." However, it will take years for shippers to realize any such benefits from unspecified and uncertain future investments. In the meantime, Berkshire has already indicated that BNSF's investment base will be boosted by **$13.9 billion**, which BNSF's customers will soon have to start paying for.

BNSF Should Be Included In STB's 2009 and in Future STB Cost of Capital Calculations

The railroads have raised the issue, but there is really no question that BNSF should be included in the STB's 2009 current cost of capital calculation. I agree with railroads that in 2009, BNSF "fully satisfied the criteria" for inclusion in 2009 calculation and should be included in the 2009 cost of capital calculation. However, I do not agree that "BNSF Data should be included in the 2009 rail industry cost of capital sample without additional modification."[21]

[19] Moody's November 3, 2009 Press Release. Moody's said it may upgrade BNSF's senior unsecured debt rating, which the agency now rates at Baa1.

[20] BNSF's 2008 embedded debt rates were 3.43% for road property and 5.24% for equipment (BNSF URCS Worktable A4, Part 3, page 103, lines 203 and 204, Col.1.)

[21] Comments of BNSF, page 3.

As indicated herein, the Berkshire/BNSF transaction does impact the 2009 cost of capital calculation. It is likely that such a down-ward adjustment to BNSF's market value would slightly increase the composite cost of capital. Whether the cost of capital goes up or down, the Berkshire/BNSF transaction is an aberration which, by its very nature and timing, should not simply be ignored. After all, it is not every day that one of the largest Fortune 500 companies buys one of the largest railroads.

I agree with KCS that the STB's criteria for inclusion in the cost of capital calculations should be revised and expanded, however, I believe that BNSF should be included in future cost of capital calculations, which will require significant modifications to the Board's methodology. I also agree with KCS that KCS, CN and CP data should, if possible, also be included in future calculations. Since there are only 7 Class I railroads left, there is no longer any need to use a sample of only 4 railroads. However, their inclusion, especially CN and CP, would present other problems for the Board.

AAR's submission indicates that in 2009 BNSF was the largest Class I railroad in terms of annual revenue with $14,123,528,000 in revenue, surpassing UP, which had $14,116,528,000 in revenue.[22] Obviously, it would be improper and illogical for the STB to exclude one of the largest Class I railroads from any industry-wide calculation. The STB cannot throw out one of the largest carriers from the mix and expect to get meaningful results, yet, at the same time, the Board should not allow an aberration associated with the largest carrier (i.e., the Berkshire/BNSF transaction) to artificially skew the results.

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[22] Verified Statement of John T. Gray, page 5, Table No. 2.

As suggested by KCS, the "time is ripe" for the STB to look at this issue and revise its methodology to insure the BNSF's data is properly included and properly adjusted in future cost of capital calculations. As indicated herein, however, in order to properly include BNSF in future cost of capital calculations will require significant revisions to the Board's methodology in regard to the determinations of railroad market values of equity and debt.

Determination of Market Values in
Future Cost of Capital Proceedings

An adjustment in BNSF's market value, however minor, will have an impact on the 2009 cost of equity calculation. However, the more important question, which was raised by KCS, is how will BNSF's market value be determined if it is included in *future* cost of capital calculations since BNSF should be included in the calculation and since it will no longer be publically traded?

Railroad market values are used in three places in the Board's cost of capital calculation: (1) year-end market values are used in determining the cost of equity using the Board's Morningstar/Ibbotson Multi-Stage Discounted Cash Flow Model (MSDCF) adopted in STB Ex Parte No. 664 (Sub-No. 1), Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital, served January 28, 2009; (2) year-end market values are used in weighing the cost of equity into a composite MSDCF cost of equity (which is then averaged with cost of equity using the Board's Capital Asset Pricing Model (CAPM) adopted in STB Ex Parte No. 664, Methodology to be Employed in Determining the Railroad Industry's Cost of Capital, served January 17, 2008); and (3) average (not year-end) market values are used in determining the debt/equity mix, which is used to develop the composite cost of capital.

Obviously, if BNSF is properly included in future calculations, either: (1) BNSF's market value will have to be determined by another method or (2) the Board's cost of capital methodology will need to be modified to replace the market values used in its calculations. For example, a fair market value could be determined based on an appraisal and valuation of BNSF's revenues, expenses, assets and liabilities. This would obviously be expensive and probably controversial. Moreover, in order to avoid an "apples and oranges" comparison, the market value for the other railroads should be determined using the same method. Alternatively, different weighing factors, such as total reported assets, could be used as a replacement for market values to weigh the cost of equity.

As noted by the Board in its January 28, 2009 decision in Ex Parte No. 664 (Sub-No. 1),, "[T]here is no single simple or correct way to estimate the cost of equity for the railroad industry, and countless reasonable options are available." I recommend that the Board open a proceeding to determine how future cost of capital calculations should be determined.

Impact of BNSF/Berkshire on the
<u>2009 Cost of Common Equity Capital</u>

The STB has specifically asked for comments on how the change in BNSF share prices from November 2009 through December 2009, following the announcement of BNSF's acquisition by Berkshire, should be considered in calculating the 2009 cost of common equity capital. As indicated, one of the major components in the STB's cost of common equity calculation is market value. Clearly, under the STB's current methodology, the jump in BNSF's stock price and market value will have an impact on the cost of capital calculation (which the STB has essentially acknowledged by the comments it seeks) and this impact should not be ignored.

The railroads maintain that "no special adjustment to the market value of BNSF share prices is warranted."[23] Witness Gray states, "Market value is simply each firm's stock price multiplied by its shares outstanding, and weights are based on the market values."[24] In other words, the railroads essentially argue that the STB has a market value approach and the market value "*is what it is*" and, therefore, should not be adjusted. Indeed, it appears that the railroads' calculations technically comply with the STB's current standards, which call for the use of stock prices in the determination of market values. However, I believe that the Board has the authority to make such an adjustment if it believes one is warranted.

Witness Gray has determined that BNSF's 2009 average market value was $26.71 billion, which is slightly higher than the 43-week pre-Berkshire average of $24.65 since the Berkshire acquisition only impacted 9 out of 52 weeks or 17.30% of 2009.[25] The STB's cost of equity calculation, however, is based on BNSF's *year-end* or December 31, 2009 market value, which Witness Gray has determined was $33.57 billion.[26] The use of the higher year-end market value decreased BNSF's cost of equity using the Board's MSDCF approach (13.10%) and increased BNSF's weight (32.24%) in the composite value calculation. As a result, a downward adjustment to BNSF's market value would likely increase BNSF's cost of equity (>13.10%), but decrease BNSF's weight (<32.24%).

I agree that market value is best reflected by the market, which, in most cases, is best represented by the stock price. In this case, however, I believe an adjustment is warranted and justified since the Berkshire acquisition only impacted the last 9 weeks of 2009, yet the year-end market value is used in cost of equity calculation.

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[23] Comments of AAR , page 2, footnote 1.
[24] Verified Statement of Witness Gray, page 42.
[25] Verified Statement of Witness Gray, page 24, Table 12.
[26] Ibid., page 41, Table 17.

I have not restated AAR's calculations to reflect such an adjustment to BNSF's market value, but such an adjustment, although appropriate, may not significantly change the STB's cost of capital calculation. One reason for this is that the market values of CSX, NS and UP also increased after the announcement of the Berkshire/BNSF transaction, which can be seen in the following Table 2:

Table 2

Increases in BNSF, CSX, NS and UP Market Values[27]

	Market Values ($000) (JTG Appendix H)		
	Week 43	Week 52	
Railroad	10/26/2009	12/28/2009	Increase
BNSF	$25,641,565	$33,573,700	$7,932,135
CSX	$16,558,135	$19,035,182	$2,477,047
NS	$17,151,214	$19,284,999	$2,133,785
UP	$27,820,844	$32,240,695	$4,419,851
Total	$87,171,758	$104,134,576	$16,962,818

A rising tide lifts all boats and, as can be seen from Table 2, the Berkshire/BNSF announcement also lifted the 2009 market values of CSX, NS and UP. As a result, the market value of all the four railroads increased and BNSF's increased market value did not significantly increase BNSF weight.

Impact of Berkshire/BNSF on the Cost of Debt

The Board has limited its request for comments concerning the impact of the Berkshire/BNSF transaction on the cost of equity, but the transaction will also impact BNSF's market values and cost of *debt* included in future cost of capital proceedings.

[27] Verified Statement of Witness Gray, Appendix H.

AAR's calculations correctly include the 2009 market value of BNSF's bonds, notes, debentures, equipment trust certificates and other debts and obligations. The AAR has determined that the total market value of debt was $30.3 billion - at least $8 billion of which belongs to BNSF.[28] It is certainly appears proper to include BNSF's 2009 debt in the cost of capital calculation since the Berkshire/BNSF transaction was not consummated until 2010.

It appears that the transaction will significantly impact future cost of debt calculations, which the Board should evaluate and consider in future calculations. According to the press release which announced the transaction, Berkshire will assume approximately $10 billion in BNSF debt. The transfer of BNSF's $10 billion debt to Berkshire (if, indeed, it is taken off the railroad's books) will significantly reduce the total market value of debt used in the cost of capital determination ($30.3 billion in 2009).[29]

Impact of Berkshire/BNSF
on the Debt/Equity Ratio

Whatever method the STB ultimately selects to determine the cost of equity, it appears that BNSF's market value will likely increase. The likely *increase* in BNSF's market value and the likely concomitant *decrease* in BNSF's debt will significantly change BNSF's current debt/equity structure and the debt/equity structure included in the STB's cost of capital calcualtions. BNSF's equity portion (78.29% in 2008) will likely near 100% with the increase in BNSF's market value and the fact that Berkshire plans to assume BNSF's debt. For example, if one assumes that BNSF's market value is $44 billion and BNSF retains a small amount of debt, say $2.5 billion in debt, BNSF's new debt / equity ratio will be 5% debt / 95% equity.

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[28] Verified Statement of Witness Gray, Appendix A.
[29] Berkshire/BNSF joint press release dated November 3, 2009.

Such a significant change in BNSF's debt/equity structure could significantly increase the composite cost of capital since the cost of equity (12.43% in 2009) is normally higher than the cost of debt (5.72% in 2009). Being able to shift debt between the railroad and the holding company (which is not limited to BNSF) allows for the manipulation of the debt/equity structure and thus the STB's cost of capital calculation.

Impact of Berkshire/BNSF
<u>on BNSF's ROI</u>

Berkshire recently announced that, as a direct result of this transaction, BNSF's investment base will increase by **$13.9 billion** to *"reflect its estimated fair value."* [30] Berkshire's filing also states that "the estimates are very preliminary and there could be material adjustments to the specific components of property, plant and equipment and in particular to amounts assigned to railroad track, structure and land." In other words, further increases in BNSF's investment base can be expected. As a direct result of this $13.9 billion increase in BNSF's investment base, BNSF's ROI will obviously drop and its revenue adequacy gap will increase.

Based on my review of BNSF's 2009 Annual report, it appears that BNSF has not yet reported this increase in its investment base to the Board since the merger was not consummated until 2010. However, it appears likely that BNSF's investment base will significantly increase in 2010 and beyond. In the following table, I have estimated BNSF's 2010 and 2011 ROI based on this $13.9 billion increase in its investment base:

[30] Berkshire S-4 SEC filing dated November 25, 2009, page 109.

Table 3

Estimated Impact on BNSF's ROI Associated With Berkshire's Planned $13.9 Billion Increase in BNSF's Investment Base

Item	2008	2009	Estimated 2010	Estimated 2011
Adjusted Net Railway Operating Income	$2,400,310	$2,071,610	$2,235,960	$2,235,960
Net Investment Base (Beginning of Year)	$22,099,489	$23,689,100	$24,078,399	$37,978,399
Net Investment Base (End of Year)	$23,575,753	$24,078,399	$37,978,399	$37,978,399
Average Net Investment Base	$22,837,621	$23,883,750	$31,028,399	$37,978,399
Return on Investment (ROI)	**10.51%**	**8.67%**	**7.21%**	**5.89%**

As can be seen, I estimate that, as a result of Berkshire/BNSF transaction, unless adjustments are adopted by the Board, it can be expected that BNSF's ROI will significantly decrease in the next few years.

Impact of Berkshire/BNSF on BNSF's Revenue Adequacy

With the anticipated reduction in BNSF's ROI, BNSF is likely to remain "revenue inadequate" for several years to come. Under the statute, the STB is supposed to determine if BNSF (and the other railroads) are able to attract capital, including the ability to repay debt and raise equity capital. There could be no more vivid demonstration of a railroad's ability to satisfy the statutory "revenue adequacy" standard than Berkshire's acquisition of BNSF. Yet, the Berkshire acquisition premium will likely have the opposite effect and move BNSF further away from revenue adequacy.

Impact of Berkshire/BNSF on BNSF's URCS Costs

In addition to reducing BNSF's ROI, Berkshire's planned increase in BNSF's investment base will increase BNSF's URCS costs. Under STB's URCS program, road property investment ($33.5 billion in 2008) is currently considered 50% variable and equipment investment ($6.9 billion in 2008) is considered 100% variable.[31] These BNSF investments (see BNSF R-1 Sch.352B) and URCS costs *will* increase as a result of the transaction. Not only will these R-1 investment and URCS costs increase, but BNSF will be entitled to a return on investment equal to the *pre-tax* current cost of capital rate of **17.31%** (as opposed to the 11.75% after tax level used in revenue adequacy determinations), which is used in the STB's 2008 URCS calculations.[32]

Berkshire also states that "For each $100 million increase in the fair value adjustment to property, plant and equipment, Berkshire would expect an annual increase in depreciation expense of approximately $4 million, assuming a weighted average life of approximately 23 years." [33] If this estimate is accurate and correct, the $13.9 billion increase in BNSF's investment base will increase BNSF's annual depreciation by **$555 million per year.** Depreciation is a major URCS cost component, thus BNSF's URCS costs will further increase.[34]

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[31] BNSF and other railroads have argued that the 50% URCS variability factor for road property should be significantly increased (by some estimates to over 80%). Such an increase in the URCS variability factor for road property would further increase the adverse impact associated with the BNSF acquisition premium. (see, e.g., BNSF June 1, 2009 comments submitted in Ex Parte No. 431 (Sub-No.3), Review of the Surface Transportation Board's Proposed Review of URCS, page 9.)

[32] STB's 2008 BNSF URCS Worktable A4, Part 3, page 105.

[33] Berkshire S-4 SEC filing dated November 25, 2009, page 109.

[34] Berkshire's S-4 SEC filing also states that the $16.5 billion of "Goodwill" which is "expected to be transferred." Berkshire states that this $16.5 billion will not be amortized but "subject to an annual impairment test." Based on this statement, it is appears likely that some of this "Goodwill" could end as "special charges" to BNSF's annual STB R-1 operating expenses, which could further increase BNSF's URCS expenses.

Summary

I applaud the Board for seeking comments concerning the impact of the Berkshire/BNSF transaction on the 2009 cost of equity calculation. I agree with the railroads that BNSF's data should be included in the 2009 cost of capital calculation. However, I believe that adjustments to the STB's calculations to reflect the Berkshire/BNSF transaction may be appropriate. It is clear that the Berkshire/BNSF transaction is an aberration which will have an impact on the 2009 cost of capital calculation, which (whether the result is up, down or minor) should be carefully evaluated and considered by the Board, which the Board has taken steps toward with this proceeding.

I respectfully submit that the STB needs to look at the total picture and should not limit or "*narrow*" its investigation and evaluation of the impact of the Berkshire/BNSF transaction on the 2009 cost of equity. The Berkshire/BNSF transaction will have a much bigger impact on STB's future cost of capital calculations, BNSF's ROI and on BNSF's URCS cost data.

One could argue about the level of the Berkshire/BNSF acquisition premium (e.g., Is it $8 or $18 billion?) and its impact, however, Berkshire has already taken steps to increase BNSF's investment base by **$13.9 billion** and anticipates an increase BNSF's annual depreciation by approximately **$555 million** per year. As a result, there is really no question that the Berkshire/BNSF transaction will:

- increase BNSF's market value;
- impact the 2009 and future cost of capital calculations;
- decrease BNSF's ROI;
- increase BNSF's revenue inadequacy gap;
- increase BNSF's URCS costs; and
- decrease BNSF's existing R/VC ratios.

As a consequence of future increases in BNSF's URCS costs, a substantial amount of existing BNSF traffic will subsequently fall below the STB's 180% R/VC jurisdictional level and BNSF will be able to justify rate increases by its lower ROI. Therefore, the Berkshire/ BNSF transaction will also result in *defacto* deregulation of BNSF traffic and allow BNSF to freely increase rates without the fear of STB intervention. In other words, Berkshire can buy BNSF for an inflated price and then get BNSF's captive customers to pay for it. Absent STB regulatory or Congressional relief, the BNSF acquisition premium will flow directly through to shippers in the form of deregulated traffic and higher rates.

The STB should consider adopting a policy of valuing all BNSF properties obtained through the Berkshire acquisition (and future acquisitions involving non-railroad entities) to based upon the BNSF's historical book values. Acquisition premiums should not be allowed to affect the STB's ROI calculations for determining railroad "revenue adequacy," and should not be allowed to affect STB's URCS calculations for BNSF. Berkshire should be responsible for the acquisition premium, not BNSF's customers.

The Board should open a proceeding, or proceedings, which thoroughly investigates ***all*** the impacts of the Berkshire/BNSF transaction, which have been identified herein. Since shippers receive virtually no benefits from the transaction, the Board should insure that shippers, such as NGFA's members, are not harmed by it.

VERIFICATION

ALEXANDRIA, VIRGINIA)
) SS.

I, Gerald W. Fauth III, verify that: I have read the foregoing statement; I know the contents thereof; and those contents are true and correct as stated.

Gerald W. Fauth III

Subscribed and sworn to me this 14th day of June, 2010

Notary Public

Howard Spratt
NOTARY PUBLIC
Commonwealth of Virginia
Reg. # 362921
My Commission Expires 7/31/2013

My Commission expires:
07-31-13

STATEMENT
OF
BACKGROUND, QUALIFICATIONS AND EXPERIENCE
OF
GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (GWF), an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. I a recognized expert on transportation issues with over 30 years experience in the private sector and in the Federal government.

This statement generally describes my background, qualifications and experience. The majority of experience has involved economic, regulatory, public policy and legislative issues primarily associated with, or related to, the U. S. railroad industry. Most of my work has involved regulatory proceedings and related projects before, or related to, the U.S. Surface Transportation Board (STB) and its predecessor, the Interstate Commerce Commission (ICC). As indicated herein, I have extensive experience in working in regulatory and other proceedings and projects involving railroad mergers, transactions, acquisitions, abandonments, rate reasonableness and other railroad related issues. These matters have involved railroad issues on a nation-wide, system-wide and individual railroad line basis.

GWF has been engaged in the economic consulting business for over 50 years. My part time affiliation with GWF began in 1972. I began working for GWF on a full-time basis on May 15, 1978 and was employed by GWF continuously until November 1, 1999 at which time I took a leave of absence in order to take a position with the STB. At the STB, I served as Chief of Staff for one of the three Board Members appointed by the President, Vice Chairman Wayne O. Burkes. I returned to GWF and consulting work effective June 23, 2003 after Mr. Burkes resigned his position to run for a political office.

Over the years, I have submitted expert testimony before ICC, STB, state regulatory commissions, courts and arbitration panels on a wide-variety of issues in numerous proceedings. In addition, I worked for 3½ years at the STB where I reviewed, analyzed and made recommendations on over 600 written formal decisions that were decided by the entire Board. These proceedings involved all matters of STB jurisdiction and had an impact on the transportation industry and the national economy.

Railroad transactions have long been the subject of ICC and STB regulatory proceedings and other matters involving: railroad merger and acquisition approval and oversight proceedings; railroad line abandonment proceedings; line sales; feeder line application proceedings; and other railroad transaction-related proceedings. I have been involved in numerous such proceedings and projects as an expert witness and as an STB staff advisor.

I was an expert witness in the last two major Class I railroad merger proceedings: STB Finance Docket No. 32760, Union Pacific Corporation, et al. – Control and Merger – Southern Pacific Rail Corporation, et al. and STB Finance Docket No. 33388, CSX Corporation, et al., Norfolk Southern Corporation, et al. – Control and Operating Leases / Agreements – Conrail, Inc., et al.. My testimony in these major merger proceedings concerned the potential adverse competitive impact of these mergers on two key areas.

In addition to my work in major railroad merger proceedings, I have submitted expert testimony in other railroad finance docket and abandonment proceedings before the ICC and STB. In these proceeding, I have developed and submitted evidence relating to the valuation and economics of the railroad line at issue, such as: going concern and net liquidation values; freight revenues and traffic; operating costs; maintenance costs: right-of-way valuation; etc.

In addition to my testimony in merger and other rail transaction proceedings, I served as an original member of the Conrail Transaction Council, which was established by the Board in Finance Docket No. 33388. This council consisted of representatives of the CSX, NS and shipper organization and provided a forum for timely and efficient communication of information and problems concerning the transaction. I was one of the original members of the Conrail Transaction Council and attended every meeting of the council until my employment with the Board.

During my time at the Board, I was actively involved in the STB merger oversight proceedings associated with the UP/SP and Conrail transactions. Perhaps the most significant merger-related proceedings that I was involved in during my time at the Board were STB Ex Parte No. 582, Public Views on Major Rail Consolidations and STB Ex Parte No. 582 (Sub-No.1), Major Rail Consolidation Procedures. These STB major rulemaking proceedings involved extensive oral hearings and written testimony from hundreds of witnesses. The Board concluded that its existing rules governing railroad mergers and consolidations, which had been developed nearly 20 years earlier, were not adequate for addressing the broad concerns expressed and initiated a major rulemaking proceeding which resulted in a major revision to the Board's rules.

I have a significant amount of experience in issues involving railroad rate reasonableness. I was actively involved in the initial ICC regulatory proceedings over 25 years ago in which the ICC first proposed and established guidelines which have since evolved into the STB's current railroad rate reasonableness guidelines. I was actively involved in several of the first cases to test the ICC's then proposed guidelines. For example, I was the primary expert witness in ICC Docket No. 40073, South-West Railroad. Car Parts Co. v. Missouri. Pacific Railroad, which was the *first* case to test the ICC's proposed simplified guidelines, which are now known as the STB's Three-Benchmark approach. More recently, I submitted extensive written and oral testimony in STB Ex Parte No. 646 (Sub-No. 1), Simplified Standards For Rail Rate Cases, on behalf of a group of 30 major stakeholders and my testimony was cited by the Board in its decision served September 5, 2007. My work and testimony in these proceedings has helped shape the STB's current rate reasonableness guidelines.

Proceedings before the Board often involve traffic and market analyses using the Board's Waybill Sample, which is a computer database of approximately 600,000 records of sampled railroad movements. I am extremely familiar with this database. Over the years, I have performed hundreds of analyses using this data which has been used as evidence in merger and other proceedings before the Board.

Many of our projects have involved the development of railroad variable cost analyses based on the application of URCS and its predecessor, Rail Form A (RFA). URCS is used to determine STB jurisdiction and is an integral component of the STB's Full-SAC method, new Simplified-SAC standard and recently modified Three-Benchmark approach. I have an extensive working knowledge of the development and application of URCS and RFA. I have prepared URCS cost analyses for thousands of individual railroad movements. I also submitted expert testimony in ICC Ex Parte No. 431 (Sub-No.1), Adoption of the Uniform Railroad Costing System as a General Purpose Costing System for Regulatory Costing Purposes and more recently in STB Ex Parte No. 431 (Sub-No. 3), Review of the Surface Transportation Board's General Costing System.

I am a 1978 graduate of Hampden-Sydney College in Hampden-Sydney, Virginia where I earned a Bachelor of Arts degree. My major areas of study were history and government. My senior paper in college dealt with the History of Railroad Deregulation. I am a 1974 graduate of St. Stephen's School for Boys (now St. Stephen's and St. Agnes School), located in Alexandria, Virginia. My senior project and paper in high school dealt with the ICC and the Energy Crisis of 1973.

My professional memberships included the Transportation Research Forum and the Association of Transportation Law Professionals.