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**ASSOCIATION OF
AMERICAN RAILROADS**

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July 15, 2010

**Honorable Cynthia T. Brown
Chief, Section of Administration
Surface Transportation Board
395 E St., S.W.
Washington, DC 20423**

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

Dear Ms. Brown:

Pursuant to the Decision served by the Board on March 30, 2010, the Association of American Railroads (AAR) hereby submits its Rebuttal Comments in the above proceeding.

Copies of the AAR's Rebuttal Comments have been served on all parties of record.

Respectfully submitted,

**Louis P. Warchot
Counsel for the Association of
American Railroads**

Attachments

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**RAILROAD COST OF
CAPITAL — 2009**

)
)
) **EX PARTE NO. 558 (Sub- No. 13)**
)

**REBUTTAL COMMENTS OF THE ASSOCIATION OF AMERICAN
RAILROADS
AND ITS MEMBER RAILROADS**

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July 15, 2010

SURFACE TRANSPORTATION BOARD

RAILROAD COST OF)
CAPITAL — 2009) EX PARTE NO. 558 (Sub- No. 13)
)
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**REBUTTAL COMMENTS OF THE ASSOCIATION OF AMERICAN
RAILROADS
AND ITS MEMBER RAILROADS**

By order served March 30, 2010, the Board instituted this proceeding to determine the railroad industry’s cost of capital for the year 2009. In its order, the Board sought comment “on the following 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., 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.” See Ex Parte No. 558 (Sub-No. 13), *Railroad Cost of Capital – 2009* (Served March 30, 2010 (Slip Op. at 1).

The Board further directed that “[c]omments should focus on the various cost of capital components ... using the methodology followed in *Railroad Cost of Capital – 2008*.” *Id.* at 2.

On May 17, 2010, in response to the Board’s March 30, 2010 order, the railroads¹, through the Association of American Railroads (“AAR”), submitted their calculation of the 2009 cost of capital using the methodology specified by the Board. The AAR calculated the railroads’ overall cost of capital for 2009 at 10.47 percent, including a cost of common equity of 12.43 percent and a cost of debt of 5.72 percent.

The AAR also responded to the Board’s request pertaining to how the change in BNSF’s share prices from November 2009 through December 2009 should be considered in calculating the 2009 cost of common equity capital. The AAR noted that the change in BNSF’s share prices from November 2009-December 2009 following the announcement of BNSF’s acquisition by Berkshire Hathaway reflected the market value of BNSF’s shares during this period and that no special adjustment to the market value of BNSF share prices was warranted.² The AAR further noted that because the BNSF acquisition was not consummated until February 12, 2010 and BNSF’s common equity was publicly traded throughout 2009, BNSF fully satisfied the criteria for inclusion in the railroad sample for the entire 2009 period.³

¹ Comments supporting the AAR’s 2009 cost of capital calculation were also filed on May 17, 2010 by BNSF and The Kansas City Southern Railway Company (“KCS”).

² Verified Statement (“V. S.”) of John T. Gray, AAR Senior Vice President, Policy and Economics V.S. Gray at pp. 24, 43-47.

³ *Id.*

On June 15, 2010, three parties filed reply comments in this proceeding: (1) the Western Coal Traffic League (“WCTL”); (2) PPL Montana, LLC/ PPL EnergyPlus, LLC and (3) the National Grain and Feed Association (“NGFA”). In these Rebuttal Comments, the AAR responds to the reply comments submitted by the above parties to the extent that such comments address the “narrow issues” that are the focus of the 2009 cost of capital proceeding and for which the Board specifically requested comment pursuant to its March 30, 2010 order.⁴ As the Board has made clear in previous cost of capital proceedings, reply comments that address issues outside the scope of the Board’s order in the annual cost of capital proceeding (including proposals for changes to the cost of capital methodology adopted by the Board) are improper and will not be considered by the Board.⁵

For the reasons stated herein (including the attached rebuttal verified statement of Mr. Gray), the challenges to the AAR’s 2009 cost of capital calculations in the reply comments are without merit and should be rejected.

⁴ KCS’s supporting comments also raised issues pertaining to the need for a separate Board proceeding to consider expansion of the composite railroad sample in future cost of capital proceedings as a result of the February 12, 2010 Berkshire Hathaway/BNSF acquisition.

⁵ See, e.g., Ex Parte No. 558 (Sub-No. 12), *Railroad Cost of Capital – 2008*, Slip Op. at 2 (served Sept. 25, 2009) (“WCTL and AECC have mounted a broad-based collateral attack on our cost-of-capital methodology in this 558 proceeding. Most of their evidence and argument relate to the claim that we should change our cost-of-capital methodology just adopted in Cost of Capital MSDCF/CAPM, particularly the decision to utilize the Morningstar/Ibbotson multistage discounted cashflow model (MSDCF) as part of our estimate.... We will not consider here the arguments presented by WCTL or AECC challenging our cost-of-capital methodology. It is settled administrative law that an agency need not, and as a matter of sound procedure should not, permit parties to relitigate generic rules in individual proceedings that apply those rules.”); see also Ex Parte No. 558 (Sub-No. 11), *Railroad Cost of Capital – 2007*, Slip Op. at 7 (served Sept. 26, 2008) (rejecting a beta calculation methodology used by WCTL that was a departure from the Board’s cost of capital methodology).

Discussion

A. WCTL Reply Comments

At the outset, it should be noted that in its reply comments filed June 15, 2010, WCTL specifically agreed with the AAR's comments on two issues of note as relevant to the 2009 cost of capital calculation.

First, WCTL agrees that BNSF should be retained in the cost of equity calculation following the Berkshire announcement that it intended to purchase BNSF's shares and that no adjustments should be made to BNSF's share price. WCTL notes that "BNSF continued to meet all the criteria after the Berkshire acquisition was announced, the announcement affected the stock of all the railroads, not just BNSF, and the impact of the announcement cannot be isolated from other factors." *See* WCTL Reply Comments at 8; *Crowley/Fapp V.S.* at 23-26.

Second, WCTL agrees with the AAR that geometric averaging rather than arithmetic averaging should be used in calculating the weekly risk-free rate of return in the Capital Asset Pricing Model (CAPM) beta calculation. "Based on our prior experiences in developing beta estimates, we have always used a geometric approach in converting the annual risk-free rates of return to daily, weekly, or monthly returns, as required by the time period used in the analysis, as this accounts for the compounding nature of interest." *See* *Crowley/Fapp V.S.* at 5; *WTCL Reply Comments* at 4. The AAR submits that use of geometric averaging rather than arithmetic averaging (as supported by both the AAR and WCTL) is a minor technical refinement to the Board's

current CAPM methodology to account correctly for the compounding of interest and should be adopted by the Board.⁶

WCTL has taken issue with the AAR's May 17, 2010 submission on five specific matters pertaining to the 2009 cost of capital calculation. As discussed below and more fully explained in the attached verified statement of Mr. Gray, WCTL's contentions are without merit and should be rejected by the Board.

1. The AAR Properly Used Data from the Railroads' 10-K Reports

WCTL claims that the AAR should have used the railroads' restated financial data for prior years (2005-2008) in calculating the five-year period (2004-2009) of normalized cash flows used in its calculation of the cost of equity under the Multi-Stage Discounted Cash Flow ("MSDCF") model instead of using the original data set forth in the railroads' 10-K reports submitted to the SEC for the prior period. WCTL Reply Comments at 5-6. WCTL's contention is without merit.

As explained in Mr. Gray's verified statement, while companies periodically restate their financial data, the AAR (consistent with the treatment of the railroads' annual 10-K statement of cash flows under the Morningstar/Ibbotson model used in the MSDCF methodology) "views the cash flow as that *perceived by the investor each year for five years*. It does not look backward in time to see how past cash flows may have changed due to accounting changes that restate past results." Gray Rebuttal V.S. at 8.

As Mr. Gray further notes, an example of the difference in these two approaches, and the appropriateness of the AAR's approach, is in the treatment of discontinued items. "Income from operations discontinued in 2009 will be excluded from the Ibbotson cash

⁶ See AAR May 17, 2010 Comments at 5, n. 4; Gray V.S at 32-33.

flow based on information from the 2009 10-K. Income from discontinued operations is considered an extraordinary item, and is not included in Ibbotson's cash flow analysis since they seek to model a firm's going-forward results. Since going-forward cash flow is the fundamental basis for estimating a firm's cost of capital, it would never be appropriate to look at past adjustments, whether due to discontinued operations or to other causes, which, by definition, can have no impact on the firm's going-forward prospects." Gray Rebuttal V.S. at 8-9.

2. The IBES Growth Rates Are From 2009 Data

WCTL claims that the AAR improperly selected IBES growth rates from January 4, 2010 instead of using values as of December 31, 2009 as required under the Board's rules. WCTL Reply Comments at 7. WCTL claim is unfounded.

As noted in Mr. Gray's verified statement, although the 2009 growth rate source data was *downloaded* by the AAR on January 4, 2010 (the first business day on which complete 2009 data was available), the data itself is as of December 31, 2009 (the last business day of the year). Indeed, *all* the downloaded data have 2009 dates. See Gray Rebuttal V.S. at 5-6.

3. The AAR's Calculation of the Median Value of Growth Rates Includes All Relevant Projections

WCTL contends, as a "second aspect" of the selection of IBES growth rates issue, that the AAR erred in calculating the median value of growth estimates for each railroad by not using the Thompson One I/B/E/S calculation. WCTL Reply Comments at 7-8.

As noted in Mr. Gray's verified statement, WCTL is advocating use of the "Thompson ONE Banker" product (which does not include all analyst growth rate projections in its median calculations because some individual analysts have not

consented to the use of their projections) and ignoring the “Thompson ONE Investment Management” and “Thompson ONE Analytics” products which *do* include all analyst growth rate estimates and which the AAR has used in this and in all previous proceedings involving the MSDCF (and single-stage DCF) methodologies to calculate a mean (and median) value. *See* April 20, 2009 AAR Comments in Ex Parte No. 558 (Sub-No. 12), *Railroad Cost of Capital—2009*, Stangle V.S. at 5.

WCTL does not dispute the actual AAR calculations regarding the median value of analyst growth estimates from “Thompson ONE Investment Management”/ “Thompson ONE Analytics.” However, the results-oriented outcome of WCTL’s proposed use of the “Thompson ONE Banker” product in this proceeding would be to exclude two of the higher analyst growth projections thus resulting in a lower cost of equity in these circumstances. WCTL’s efforts to manipulate the analyst growth rate projections to obtain a lower cost of equity in this proceeding should be rejected.

4. The AAR’s Equipment Trust Certificates (ETC) Stated Value Is Correct

WCTL contends that the AAR misstated the value of BNSF’s ETCs at \$236.7 million (in Tables 6 and 7 of Mr. Gray’s verified statement) and that the correct ETC value of \$243 million is shown in Appendix C of Mr. Gray’s verified statement. WCTL contends that “[u]sing the correct figure does not materially impact the composite cost of debt, but it does alter the equity/debt ratio.” WCTL Reply Comments at 8. WCTL’s contention that the AAR used the wrong ETC value in its calculation of the cost of debt is unfounded.

As noted in Mr. Gray’s verified statement, the BNSF ETC values used in the AAR’s Tables 6 and 7 are indeed the correct values and were in fact used in the AAR’s

calculation of the cost of debt and the weighted average cost of capital.⁷ The AAR is accordingly submitting a corrected Appendix C showing the correct ETC value. See Gray Rebuttal V.S. at 3-4.

5. All AAR Workpapers Provided to the STB Have Been Given To WCTL

WCTL contends that the AAR improperly failed to produce all the electronic workpapers (Excel spreadsheets) that WCTL had requested to verify the AAR's cost of capital calculations. WCTL Reply Comments at 10-12.

To the contrary, as noted in Mr. Gray's verified statement, "all of [the AAR's] submissions to the STB have also been made available to other participants—including workpapers." Gray Rebuttal V.S. at 10.⁸ The AAR's workpapers included two electronic spreadsheets used for the CAPM beta calculation. *Id.* Indeed, the STB has not found that additional spreadsheets from the AAR beyond that already provided are necessary for review of AAR's calculations and they are in fact unnecessary. (The AAR's replication and analysis of WCTL's calculations was completed without the need for WCTL's own spreadsheets.)

If the STB had requested the AAR to provide additional spreadsheets for any reason, the AAR would have provided them both to the STB and to the parties (subject to appropriate protective conditions). No additional spreadsheets are in fact necessary.

The remaining issues raised by WCTL in its reply comments are, as WCTL itself implicitly admits, either improper collateral attacks on the Board's cost of capital

⁷ The Appendix C submitted in Mr. Gray's May 17, 2010 statement was an out-of-date version that did not include a later correction. The correction was used in all other tables and appendices.

⁸ In this proceeding the AAR submitted to the STB (and made available to WCTL) "a 250-page PDF file of work papers that contained bookmarks, was searchable, and had the data/text selection feature enabled." The AAR also provided two spreadsheets used for the calculation of the Capital Asset Pricing Model's beta. Gray Rebuttal V.S. at 10.

methodology⁹ or beyond the scope of the specific issues set forth in the Board's March 30, 2010 order soliciting comments in the 2009 cost of capital proceeding.¹⁰ These extraneous comments have no role in the 2009 annual cost of capital proceeding and should not be considered by the Board.

B. PPL Montana, LLC/ PPL EnergyPlus, LLC Reply Comments

PPL Montana, LLC/ PPL EnergyPlus, LLC generally support the comments of WCTL as relevant to the 2009 cost of capital proceeding (Reply Comments at 2), and, accordingly, the AAR's above response to WCTL's arguments apply to PPL Montana, LLC/ PPL EnergyPlus, LLC comments as well.

C. NGFA Reply Comments

NGFA's "reply comments" consist solely of a verified statement from witness Fauth raising a series of issues that (apart from its discussion regarding the treatment of BNSF shares in calculating the 2009 cost of common equity) are wholly extraneous to the 2009 cost of capital proceeding. Indeed, NGFA's "reply comments" make no attempt whatsoever to stay within the parameters of the annual cost of capital proceeding as

⁹ WCTL notes that reports filed by Berkshire Hathaway with the SEC indicate that BNSF's cost of equity was calculated by two financial analysts for purposes of the Berkshire/BNSF acquisition using valuation methods different from the Board's MSDCF and hybrid approaches and that the resulting cost of equity calculations were lower than under the Board's established methodology. WCTL comments at 4, 9-10. As the Board has specifically noted, WCTL is free to propose changes to the Board's established methodology in a separate rulemaking proposal if it so chooses, but such collateral attacks are improper in the annual cost of capital proceeding and will not be considered by the agency. See note 4, *supra*. Indeed, WCTL itself admits that its collateral attack on the MSDCF methodology as producing "overstated" cost of equity values "is not strictly within the scope of the Notice." *Id* at 9.

¹⁰ WCTL admits that the "issue of how to calculate the cost of capital in future years, when BNSF might no longer be considered in the analysis because it ceased to be traded earlier in 2010, was not included in the Board's Notice" and "that the issue is [not] properly noticed or implicated in the 2009 cost of capital determination." WCTL Reply comments at 4.

delineated in the Board's March 30, 2010 order defining the scope of this proceeding.

The issues improperly raised and discussed in the Fauth verified statement include such extraneous matters as whether it would be proper to exclude BNSF from *future* cost of capital proceedings (Fauth V.S. at 11-12); how the BNSF investment base should be treated in *future* costs of capital proceedings *if* BNSF remains in the railroad sample (Fauth V.S. at 13); whether the "acquisition premium" paid by Berkshire Hathaway should be permitted to increase BNSF's book value *after 2009* (Fauth V.S. at 15-17); and whether as a result of an increase in BNSF's investment base *in 2010 and beyond* following the Berkshire acquisition in February 2010, BNSF's *future* return on investment (ROI) will significantly drop and its "revenue adequacy gap" significantly increase resulting in "de facto deregulation" of BNSF traffic (Fauth V.S. at 17-21).

To the extent that NGFA's comments improperly address issues that are beyond the scope of this proceeding – as they clearly do -- AAR will not respond to them, and they should not be considered by the Board.

The AAR simply notes that, contrary to the assertion of "de facto deregulation" in the Fauth verified statement, the fact that a carrier may be revenue inadequate provides no immunity whatsoever from shipper rate challenges (or claims of unreasonable practices) under the ICC Termination Act and that any such assertion is groundless. *See, e.g.,* STB Docket No. 42088, *Western Fuels Association, Inc. and Basin Electric Power Cooperative v. BNSF Railway Company* (served Feb. 18, 2009); STB Docket No. 42095, *Kansas City Power & Light Company v. Union Pacific Railroad Company* (served May 19, 2008); *US Magnesium L.L.C. v. Union Pacific Railroad Company*, STB Docket No.

42114 (served Jan. 28, 2010) (“*US Magnesium*”), appeal docketed, No. 10-1019, *Union Pacific Railroad Company v. Surface Transportation Board* (D.C. Cir. Feb. 2, 2010).

Moreover, if NGFA has any specific issue or issues it wishes to raise before the Board regarding Board accounting policies or procedures, or proposed changes in the Board’s cost of capital methodology for use in future proceedings, it is free to raise any such issues outside the strictly-defined context of the annual cost of capital proceeding through a separate rulemaking petition requesting the Board to address the issue.¹¹

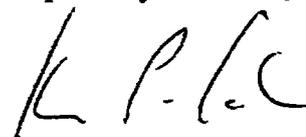
On the one relevant issue addressed in the NGFA/Fauth verified statement (the treatment of BNSF common equity shares for the period November 2009-December 2009 after the Berkshire acquisition announcement), NGFA/Fauth does not offer an alternative to AAR’s use of unadjusted BNSF share prices after the Berkshire acquisition announcement for purposes of calculating the 2009 cost of equity and the 2009 overall cost of capital.

¹¹ See Ex Parte No. 558 (Sub-No. 12), *Railroad Cost of Capital – 2008*, Slip Op. at 2 (served Sept. 25, 2009) (“We have established a procedural framework whereby in the Ex Parte No. 558 sub-numbered proceedings (558 proceedings) to determine the annual cost-of-capital figure, we are limited to applying the cost-of-capital methodology in place at the time, as determined in the Ex Parte No. 664 proceeding (664 proceeding). See *Methodology To Be Employed In Determining The Railroad Industry’s Cost Of Capital*, STB Ex Parte 664, slip op. at 18 (STB served Jan. 17, 2008) (*Cost of Capital CAPM*). Proposed changes to the cost-of-capital model will be entertained only in the 664 proceeding. This allows the Board to complete its annual cost-of-capital determination in a timely manner and to provide all stakeholders with a meaningful opportunity to comment on any proposed methodological changes.”) Indeed, NGFA itself clearly recognizes in its filing that the extraneous issues it improperly seeks to insert in this proceeding can only be properly considered through separate rulemaking petitions and that this is in fact the appropriate procedure. See Faust V.S. at 21 (recommending that the Board “open a proceeding, or proceedings” with respect to the various extraneous (and post-2009) cost of capital and regulatory issues it improperly discusses in its comments).

Conclusion

The Board should determine that the railroads' cost of capital for 2009 is 10.47 percent.

Respectfully submitted,



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**Counsel for the Association of American Railroads
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July 15, 2010

CERTIFICATE OF SERVICE

I hereby certify on this 15th day of July, 2010, I served by first class mail, postage prepaid, a copy of the forgoing on the following:

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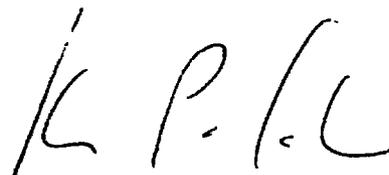
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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**EX PARTE NO. 558 (Sub-No. 13)
RAILROAD COST OF CAPITAL — 2009**

**REPLY VERIFIED STATEMENT
OF
JOHN T. GRAY
SENIOR VICE PRESIDENT — POLICY AND ECONOMICS
ASSOCIATION OF AMERICAN RAILROADS**

July 15, 2010

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List of Appendices

Appendix C - Equipment Trust Certificates (corrected*)

Appendix AA - WCTL Cost of Capital with capital structure corrected

Appendix AB - WCTL Cost of Capital with capital structure corrected and all growth rates

*** A number in Appendix C was corrected prior to the AAR's May 17 filing, and corrected data was used in all calculations, footnotes, tables, and appendices – except Appendix C, which still had the uncorrected number.**

**Verified Statement
of
John T. Gray**

I. Introduction

My name is John T. Gray. I am Senior Vice President – Policy and Economics of the Association of American Railroads (AAR), with offices at 425 Third Street, S.W., Washington, DC 20024. The AAR is the trade association of the Nation’s major railroads, as well as the railroads of Canada and Mexico. The AAR’s United States railroad members, which include all of the Class I railroads, account for about 95 percent of our Nation’s total railroad freight operating revenue.

When appropriate, the AAR represents the railroad industry before government bodies, including economic regulatory proceedings before the Surface Transportation Board (“STB” or “Board”). In particular, the AAR has participated in all of the STB proceedings addressing revenue adequacy standards and the annual cost of capital determinations.

I submitted a verified statement on behalf of the Association of American Railroads in this proceeding on May 17, 2010, and a summary of my qualifications and experience appears at the end of that statement. In this submission, I am responding to comments filed by the Western Coal Traffic League (WCTL) on June 15, 2010.

II. General Comments

I have some summary observations about the Western Coal Traffic League (WCTL) reply comments. First, WCTL’s “correction” to the AAR’s capital structure figures changed a correct calculation into an incorrect one.

Second, WCTL has accused the AAR of “manipulation or circumvention of Thomson’s quality controls” in the use of growth rates, when *WCTL itself was the manipulator* by using exactly the same analyst growth rate projections as AAR with the exception of two of the higher analyst growth projections – *which were excluded*.¹ The AAR growth rates were appropriate and all-inclusive. All growth rates were from 2009, as was plainly stated on all rates shown in Appendix L.

Third, the AAR used cash flow data from each year’s 10-K report, a procedure that has been followed every time the MSDCF has been used by the STB to determine a cost of equity. AAR has been clear and consistent in its methodology.

Fourth, WCTL complaints about AAR work papers are unwarranted. The AAR provided the WCTL with everything that was provided to the STB, including two spreadsheets for the calculation of the Capital Asset Pricing Model’s beta. The STB has obviously found the information submitted adequate, and it has not asked for additional information. Of course, if the STB were to ask for additional information, and impose appropriate protective conditions for proprietary data, if needed, AAR would be pleased to provide it.

III. Detailed Comments

A. WCTL Adjustment to the Market Value of Debt

WCTL has, in effect, “undone” a last-minute correction to the market value for Equipment Trust Certificates (ETCs). The figures used in all of my tables in my May 17 statement, and in my Appendix E (Market Value of Debt), are correct.

¹ See Verified Statement of Crowley and Fapp, page 14.

B. Growth Rates

Consultants for WCTL have accused me of using growth rate data “four days into the next year” and of using “manipulation or circumvention of Thomson’s quality controls.”² Actually, WCTL’s consultants are the ones who have manipulated the data. They have used exactly the same growth rate data that I have used (as shown below), except they excluded the highest expected rates for BNI and for CSX.³

AAR 2009 Median Growth Rates for MSDCF							
Analyst Growth Rates from IBES December 31							
Company	Rate 1	Rate 2	Rate 3	Rate 4	Rate 5	Rate 6	Median
BNI	7.1	14.0	12.0	—	—	—	12.00 %
CSX	11.6	15.0	10.0	11.5	13.0	—	11.60
NSC	2.8	15.0	12.0	12.0	12.0	—	12.00
UNP	13.1	10.0	15.0	13.0	15.0	—	13.10
Simple Average of Medians = 12.18 percent.							

WCTL 2009 Median Growth Rates for MSDCF							
Analyst Growth Rates from IBES December 31							
Company	Rate 1	Rate 2	Rate 3	Rate 4	Rate 5	Rate 6	Median
BNI	7.1		12.0	—	—	—	9.55 %
CSX	11.6		10.0	11.5	13.0	—	11.55
NSC	2.8	15.0	12.0	12.0	12.0	—	12.00
UNP	13.1	10.0	15.0	13.0	15.0	—	13.10
Simple Average of Medians = 11.55 percent.							

The claim that the AAR is using growth rates from 2010 is misleading and obviously wrong. As can be easily seen in the source documents from my May 17 Appendix L, the *download* date is January 4, 2010, around 8:00 AM – first thing in the morning – and the first business day on which complete set of 2009 data was available. January 3 was a Sunday. January 2 was a Saturday, and January 1 was the New Year’s Day holiday. Nothing could have changed since December 31, 2009 – the last business day of the year. Most importantly, all of

² See Ex Parte No. 558 (Sub-No. 13), Reply Comments of the Western Coal Traffic League, June 15, 2010, Reply Verified Statement of Thomas D. Crowley and Daniel L. Fapp, page 14.

the dates on the four downloaded data pages were prior to 2010, including the date for the current expected growth rate and the date the latest growth rate was reviewed. If one were to look at Appendix L, page 2, from a landscape perspective (see portion of BNI page below), the review dates are on the far right. The BNI review dates are “Nov 04, 09”, “Dec 07, 09”, and “Nov 03, 09”. None of the dates for the rates say 2010. All of the CSX growth rate estimates are also from 2009. There is no reason to exclude any growth rate numbers.

Company	Broker	Analyst	Current	Case	Price	Review	Update
BP	BNY CAPITAL MARKETS	MCNEIL	1.10	Oct 23, 09	2.00	Aug 04, 09	Nov 04, 09
BP	WELLS FARGO BANK	MCNEIL	1.10	Nov 17, 09	10.00	Jan 23, 02	Dec 07, 09
BP	MORGAN MORGAN & COMPANY INC.	MATHELOJA	22.00	May 18, 07	NA	NA	Nov 09, 09

Revisions: Deleted Cash flows & rates are excluded from the Mean calculation

There is also no “quality control” issue. If there was a problem with a number, Thomson would not have included it in the publication. WCTL appears to have chosen to rely on numbers from the Thomson ONE Banker service because this source is useful (this time) for their goal of calculating a lower cost of equity. However, as explained on page 39 of my May 17, 2010 statement, and in footnote 4 of page 5 of Dr. Bruce Stangle’s April 20, 2009, statement, Thomson ONE Banker service does not include all growth rates in its median calculations. However, other Thomson ONE products, such as the Thomson ONE Analytics that the AAR currently uses, provide all growth rates, and all of these rates were provided in my May 17 Appendix L. When the (single-stage) Discounted Cash Flow model was used by the Board and its predecessor, all growth rates were included in calculations.⁴ There is no reason, nor has any legitimate justification been provided, which would substantiate exclusion of some of the growth rates now. The reason Thomson ONE Banker service excludes some rates is because the broker has not

³ Compare to Table 2 on page 15 of Crowley and Fapp’s June 15 Reply Comments.
⁴ All long-term growth rates were used to calculate a mean. A “truncated” mean was also calculated, which eliminated the highest and lowest growth rate estimates from the calculation. If any growth rates had been excluded from the original group of growth rates, the truncated mean would have eliminated the highest and lowest growth rate estimates using a smaller group of rates.

given Thomson permission to use its rate in a mean calculation (see check boxes at far left of BNI example above). The decision to exclude those growth rates from the mean (and median) calculated by Thomson is solely that of the analyst who has developed the rates. Clearly, since Thomson has published these rates as “stand alone” growth estimates, they have passed all “quality control” processes that Thomson found necessary. There is no problem with the quality of the growth rate projections.

To summarize, the AAR has correctly included *all Thomson growth rates available, no rates are from 2010, and all rates were made available in Appendix L* in my May 17 statement. WCTL has manipulated results by omitting two high growth rates, and then used a “smokescreen” by making self-serving accusations of “2010” data, “manipulation” and “circumvention of Thomson’s quality controls”.

C. Using Restated Cash Flow Data

We are aware that companies periodically restate their financial data. However, our understanding of the Ibbotson model is that each year’s data is sourced from that year’s 10-K report. The sources are clear at the beginning of Dr. Bruce Stangle’s work papers for the 2008 cost of capital, and I confirmed that we use that procedure on page 38 of my May 17 statement. The process views the cash flow as that *perceived by the investor each year for five years*. It does not look backward in time to see how past cash flows may have changed due to accounting changes that restate past results. These restatements do not reflect changes in the business prospects or cash flow expectations from these prospects going forward. They particularly do not reflect the investor perceptions of the firm that existed at the time the original financial data was published. Since these are the perceptions that form the basis for an investor’s decisions regarding the firm at that time, they are those which are properly modeled to determine the firm’s

cost of capital at each point in time. *The current computation process correctly recognizes that these measurements are "stand alone" each year, and that past perceptions are not changed by current accounting restatements.*

An example is the treatment of discontinued items. Income from operations discontinued in 2009 will be excluded from the Ibbotson cash flow based on information from the 2009 10-K. Income from discontinued operations is considered an extraordinary item, and is not included in Ibbotson's cash flow analysis, since they seek to model a firm's going-forward results. Since going-forward cash flow is the fundamental basis for estimating a firm's cost of capital, it would never be appropriate to look at past adjustments, whether due to discontinued operations or to other causes, which, by definition, can have no impact on the firm's going-forward prospects.

Our procedure has been to stay consistent with practices decided in the 2008 cost of capital determination (as specified by the STB), and consistent with the investor's contemporaneous perception of the cash flow for each year as the results for that year are reported. In short, investor expectations are based on the then-current financial condition of a company and its forward prospects. Subsequent restatements do not change prior investor perceptions or decisions. Part of the cost of capital computation is a measurement of the change, over time, of these individual year-by-year expectations of the firm's going-forward cash flows.

A more complicated aspect of five-years of cash flow data is the BNSF presentation of capital expenditures. From the 2008 BNSF 10-K statement of cash flows, BNSF had a line labeled "capital expenditures". From our point of view, "capital expenditures" would mean capital expenditures to an investor in 2008, and should be used in the Ibbotson cash flow five-year smoothing process.

This is the 2008 BNSF 10-K. Compare to the 2009 10-K

	2008	2007	
Investing Activities			
Capital expenditures	(2,175)	(2,248)	(2,014)
Construction costs for facility financing obligation	(84)	(37)	114
Acquisition of equipment pending financing	(941)	(745)	(1,223)
Proceeds from sale of assets financed	348	778	1,244
Other, net	(241)	(163)	(160)
Net cash used for investing activities	(3,073)	(2,415)	(2,187)

However, BNSF's 2009 10-K cash flow statement presents an entirely different picture for 2009 and 2008 (see below).

This is the 2009 BNSF 10-K. Compare to the 2008 10-K

	2009	2008	2007
Investing Activities			
Capital expenditures excluding equipment	(1,991)	(2,167)	(2,248)
Acquisition of equipment	(733)	(949)	(745)
Proceeds from sale of equipment financed	368	348	778
Construction costs for facility financing obligation	(37)	(64)	(37)
Other, net	(244)	(241)	(163)
Net cash used for investing activities	(2,637)	(3,073)	(2,415)

Two issues:
 1) Should restated data be used?
 2) Which lines are Capex?

To stay consistent with investor expectations for a particular year, we used "Capital expenditures excluding equipment" plus "Acquisition of equipment" for 2009 capital expenditures, and we continued with "Capital expenditures" from the 2008 10-K as the 2008 figure.

D. Work Papers

As we have in the past, all of our submissions to the STB have also been made available to other participants – including work papers. I submitted to the STB a statement that contained 21 tables and Appendices A through L. I also submitted a 250-page PDF file of work papers that contained bookmarks, was searchable, and had the data/text selection feature enabled. We also provided two spreadsheets used for the calculation of the Capital Asset Pricing Model's beta. All of these were also made available to the Western Coal Traffic League.

Two types of spreadsheets will have little value to other users. First, some spreadsheets have few (or no) calculations, and have no value to other parties. An example is my Table 13 that simply displays fifteen annual bond rates. A second type of AAR spreadsheet is the debt

spreadsheet that contains a subscription service's proprietary bond data. The spreadsheet does not "link" to another spreadsheet with the bond data – the bond data are already in the spreadsheet to enable lookup functions. Removing the bond data would cause the lookup functions to fail elsewhere in the spreadsheet, resulting in each bond saying "Not Traded" in the field for its price – considerably reducing the usefulness of the file.

Participants in previous cost of capital proceedings already have their own spreadsheets from earlier years, and these can be updated from data found independently or from AAR Appendices and work papers. (Our replication and analysis of WCTL's calculations was completed by adding the WCTL numbers to our own spreadsheets.) The STB has not indicated other spreadsheets are necessary for their review of our calculations – quite likely because it simply transferred numbers from my Appendices and work papers into STB spreadsheets that already exist. If the STB had requested more spreadsheets, we would have provided those in addition to those already sent to the STB, and would make them available for requesting parties – assuming the necessary protective conditions for any proprietary data could be developed.

IV. Calculations

We continue to believe our original May 17, 2010, calculation for the 2009 cost of capital (10.47 percent) is accurate, and derived from procedures used for the 2008 calculation. However, we note that in the 2008 cost of capital decision, the Board said that the AAR "has not contested the accuracy" of WCTL's calculation.⁵ Therefore, I have provided a comparison of various scenarios for the 2009 cost of capital calculation, with more detail on corrections to the WCTL calculation in Appendices AA and AB.

⁵ Ex Parte No. 558 (Sub-No. 12), Railroad Cost of Capital – 2008, served September 25, 2009, page 9.

Various Cost of Capital Scenarios

	MSDCF Cost of Equity	Cost of Capital	No. of Growth Rates	Correct Capital Struct.	10-K Orig. Restated	Reference
AAR, original	13.46%	10.47%	18	Yes	Orig.	AAR May 17
WCTL, original	13.04%	10.33%	16	No	Restated	WCTL June 15
<i>These are WCTL numbers with the impact of their incorrect changes.</i>						
WCTL 2	13.04%	10.32%	16	Yes	Restated	Appendix AA
WCTL 3	13.34%	10.43%	18	Yes	Restated	Appendix AB

We believe the original AAR calculation is correct because it uses all 18 of the available growth rates at the end of 2009, and uses cash flows based on original 10-K reports. WCTL's calculation is flawed because it uses a wrong capital structure, omits two growth rates, and uses restated cash flow data.

By correcting only WCTL's incorrect capital structure, WCTL's cost of capital calculation becomes 10.32 percent (WCTL 2 in the table) instead of 10.33 percent. This is a minor difference.

Making a second correction to the WCTL methodology, by adding the omitted growth rates back into the median calculation (WCTL 3 in the table), changes the cost of capital to 10.43 percent. WCTL's omitting two growth rates (that happen to be higher ones) is particularly egregious, and is the most significant problem with the WCTL calculations. Computations consistent with established practice, and with computational integrity, do not permit omitting any IBES/Morningstar growth rates. However, should the STB somehow decide that WCTL's new arbitrary methodology is appropriate, the STB will also need to provide detailed guidance on how future growth rates are to be selected, since there will be no clarity as to which should be selected and which should be excluded.

Once the minor and major corrections are made to WCTL calculations, the WCTL cost of capital becomes 10.43 percent. The .04 percentage point difference from the AAR 10.47 percent

cost of capital calculation is caused by using restated 10-K data.

V. Summary

The original May 17, 2010, AAR calculation for the cost of capital is the appropriate number, and it is 10.47 percent. We believe that the types of adjustments proposed by WCTL are simply an attempt to manipulate numbers in order to achieve a desired result. Unlike WCTL, we have used all of the appropriate growth rates in our MSDCF model, just as all growth rates have been used for every past single or multi-stage DCF calculation. We also have used original 10-K numbers for our cash flows, as has been done in the past, to properly reflect investor perceptions during each year.

VERIFICATION

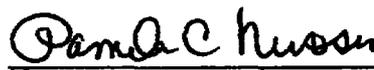
WASHINGTON, D.C.)
) SS.

I, John T. Gray, being duly sworn, state that I have read the foregoing statement, that I know its contents, and that those contents are true as stated.



JOHN T. GRAY

Subscribed and sworn to before me this 14th day of July 2010.



Notary Public

My Commission expires:

Pamela C. Hwoso
Notary Public, District of Columbia
My Commission Expires 2/14/2012

Equipment Trust Certificates for BNSF

Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)			Current Valuation		Current (\$000)	
		Beg.	Ending	Avg O/S	Interest Rate	Valuation Factor	Market Value	Interest
1. BNSF Series AA (AT	9/24/11	6,705	4,470	5.588	2.528%	1.09498	6,118	155
2. BNSF 1999A	5/1/14	19,992	16,660	18.326	3.458%	1.08832	19,945	690
3. BNSF 1999 KFW	6/28/16	63,661	55,704	59.683	3.909%	1.12386	67,075	2,622
4. BNLC Dec98 KFW	1/2/2016	61,230	57,348	59.289	3.912%	1.07991	64,027	2,505
5. BNLC 2000 KFW	4/19/15	23,408	20,064	21,736	3.716%	1.14818	24,957	928
6. BNLC 2005-1 (1993 PT	01/02/12	22,581	15,694	19,138	2.864%	1.03359	19,780	567
7. BNSF 2009-B EDC ETC	7/15/2027	74,912	72,831	73,872	4.508%	1.02655	34,757	1,567
8.				--			--	--
9.				--			--	--
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12.				--			--	--
13.				--			--	--
14.				--			--	--
15.				--			--	--
Total		\$272,489	\$242,771	\$257,630	3.816%		\$236,658	\$9,032

New ETC issued 7/15/2009 market value has been pro-rated at (5.5 months / 12 months) times market value of \$75,833.

Note:
 This list contains ETCs that can be used in the AAR's model to determine market value. Some debt instruments labeled as ETCs do not have all of the characteristics typical of an ETC, and therefore cannot be modeled. For example, ETCs with variable rates cannot be modeled.

Non-Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)	
		Beg.	Ending
1. BNLC - Barbados	04/16/12	16,932	11,920
2. BNLC - 1992 ETC	07/14/13	13,913	11,131
3. BNLC - 1995A.PTT(t	07/01/13	5,515	4,834
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15.			
Total		\$36,360	\$27,885

Equipment Trust Certificates for BNSF (continued)

Entire ETC Current – Not Used for Cost or Market Value

ETC ID	Maturity	Balance 2009 (\$000)	
		Beg.	Ending
1.			
2.			
3.			
4.			
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6.			
7.			
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12.			
13.			
14.			
15.			
<hr/> Total		\$0	\$0

Grand Totals (for reconciliation to carrier data)

	Balance For 2009 (\$000)	
	Beg.	Ending
Total Modeled	\$272,489	\$242,771
Total Non-Modeled	38,360	27,885
<hr/> Sub Total	308,849	270,656
Total All Current	0	0
<hr/> Grand Total	308,849	270,656
From BNSF:		
Total ETCs		\$270,656
Difference		\$0

Equipment Trust Certificates for CSX

Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)			Current Valuation		Current	
		Beg.	Ending	Avg O/S	Interest Rate	Valuation Factor	Market Value	Interest
1. ETC CSX Series A 231	3/15/11	11,400	7,600	9,500	2.074%	1.09462	10,399	216
2. ETC CSX Series B 236	2/15/14	30,000	25,000	27,500	3.004%	1.09264	30,048	903
3. ETC CSX Series B 237	4/15/14	24,000	20,000	22,000	3.002%	1.11162	24,456	734
4. ETC CSX Series B 238	6/15/14	22,200	18,500	20,350	3.000%	1.13657	23,129	694
5. ETC CSX Series B 239	4/1/15	35,700	30,600	33,150	3.261%	1.17366	38,907	1,269
6. ETC CSX Series B 240	5/15/15	29,400	25,200	27,300	3.263%	1.14323	31,210	1,018
7.				--			--	--
8.				--			--	--
9.				--			--	--
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11.				--			--	--
12.				--			--	--
13.				--			--	--
14.				--			--	--
15.				--			--	--
Total		\$152,700	\$126,900	\$139,800	3.056%		\$158,148	\$4,834

Note:

This list contains ETCs that can be used in the AAR's model to determine market value. Some debt instruments labeled as ETCs do not have all of the characteristics typical of an ETC, and therefore cannot be modeled. For example, ETCs with variable rates cannot be modeled.

Non-Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)	
		Beg.	Ending
1.			
2. ETC CSX Series A 234	06/01/11	12,000	8,000
3. ETC CSX Series A 235	06/15/13	25,000	20,000
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12.			
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14.			
15.			
Total		\$37,000	\$28,000

Equipment Trust Certificates for CSX (continued)

Entire ETC Current – Not Used for Cost or Market Value

ETC ID	Maturity	Balance 2009 (\$000)	
		Beg.	Ending
1 ETC CSX Series B 228	3/15/10	7,800	3,900
2 ETC CSX Series A 230	06/01/10	7,600	3,800
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14			
15			
Total		\$15,400	\$7,700

Grand Totals (for reconciliation to carrier data)

	Balance For 2009 (\$000)	
	Beg.	Ending
Total Modeled	\$152,700	\$126,900
Total Non-Modeled	37,000	28,000
Sub Total	189,700	154,900
Total All Current	15,400	7,700
Grand Total	205,100	162,600
From CSX:		
Total ETCs		\$162,600
Difference		\$0

Equipment Trust Certificates for NS

Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)			Current Valuation		Current	
		Beg.	Ending	Avg O/S	Interest Rate	Valuation Factor	Market Value	Interest
1. NSR Series H	7/15/13	21,000	16,800	18,900	2.727%	1.07896	20,392	556
2. NSR Series I	4/1/14	37,800	31,500	34,650	3.003%	1.10172	38,175	1,146
3. NSR Series J	7/1/14	37,500	31,250	34,375	3.000%	1.14003	39,189	1,176
4.				--			--	--
5.				--			--	--
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10.				--			--	--
11.				--			--	--
12.				--			--	--
13.				--			--	--
14.				--			--	--
15.				--			--	--
Total		\$96,300	\$79,550	\$87,925	2.944%		\$97,756	\$2,878

Note.
This list contains ETCs that can be used in the AAR's model to determine market value. Some debt instruments labeled as ETCs do not have all of the characteristics typical of an ETC, and therefore cannot be modeled. For example, ETCs with variable rates cannot be modeled.

Non-Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)	
		Beg.	Ending
1.			
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12.			
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14.			
15.			
Total		\$0	\$0

Equipment Trust Certificates for NS (continued)

Entire ETC Current – Not Used for Cost or Market Value

ETC ID	Maturity	Balance 2009 (\$000)	
		Beg.	Ending
1.			
2.			
3.			
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10.			
11.			
12.			
13.			
14.			
15.			
Total		\$0	\$0

Grand Totals (for reconciliation to carrier data)

	Balance For 2009 (\$000)	
	Beg.	Ending
Total Modeled	\$96,300	\$79,550
Total Non-Modeled	0	0
Sub Total	96,300	79,550
Total All Current	0	0
Grand Total	96,300	79,550
From NS:		
Total ETCs		\$79,550
Difference		\$0

Equipment Trust Certificates for UP

Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)			Current Valuation		Current	
		Beg.	Ending	Avg O/S	Interest Rate	Valuation Factor	Market Value	Interest
1. ETC UPC Series C	2/1/12	16,600	12,450	14,525	2.404%	1.13482	16,483	396
2. ETC UPC Series G	6/15/11	16,305	10,870	13,588	2.074%	1.10084	14,958	310
3. ETC UPC Series H	12/1/11	14,100	9,400	11,750	2.074%	1.08985	12,806	266
4. ETC UPC Series I	2/23/19	64,194	58,701	61,448	3.869%	1.14811	70,548	2,730
5. ETC UPC Series J	1/2/2031	90,819	86,822	88,820	4.665%	1.13379	100,704	4,698
6.				--			--	--
7.				--			--	--
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10.				--			--	--
11.				--			--	--
12.				--			--	--
13.				--			--	--
14.				--			--	--
15.				--			--	--
Total		\$202,018	\$178,243	\$190,130	3.898%		\$215,499	\$8,400

Note:
 This list contains ETCs that can be used in the AAR's model to determine market value. Some debt instruments labeled as ETCs do not have all of the characteristics typical of an ETC, and therefore cannot be modeled. For example, ETCs with variable rates cannot be modeled.

Non-Modeled ETCs

ETC ID	Maturity	Balance For 2009 (\$000)	
		Beg.	Ending
1.			
2.			
3.			
4.			
5.			
6.			
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12.			
13.			
14.			
15.			
Total		\$0	\$0

Equipment Trust Certificates for UP (continued)

Entire ETC Current – Not Used for Cost or Market Value

ETC ID	Maturity	Balance 2009 (\$000)	
		Beg.	Ending
1.			
2.			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			
11.			
12.			
13.			
14.			
15.			
Total		\$0	\$0

Grand Totals (for reconciliation to carrier data)

	Balance For 2009 (\$000)	
	Beg.	Ending
Total Modeled	\$202,018	\$178,243
Total Non-Modeled	0	0
Sub Total	202,018	178,243
Total All Current	0	0
Grand Total	202,018	178,243
 From UP:		
Total ETCs		\$178,243
Difference		\$0

2009 Median Growth Rates for MSDCF AAR Replication of WCTL Growth Rates

Company	Analyst Growth Rates from IBES December 31						Median
	Rate 1	Rate 2	Rate 3	Rate 4	Rate 5	Rate 6	
BNI	7.1	--	12.0	--	--	--	9.55 %
CSX	11.6	--	10.0	11.5	13.0	--	11.55
NSC	2.8	15.0	12.0	12.0	12.0	--	12.00
UNP	13.1	10.0	15.0	13.0	15.0	--	13.10

Simple Average of Medians = 11.55 percent.

14.0 omitted from BNI and
15.0 omitted from CSX

Cash Flow Calculation - AAR Replication of WCTL

BNSF	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ In millions)						
Revenue	12,987	14,985	15,802	18,018	14,016	75,808
Net Income	1,534	1,889	1,829	2,115	1,721	9,088
Extraordinary Items	0	0	0	0	0	0
Depreciation	1,111	1,176	1,293	1,397	1,537	6,514
Deferred Taxes	219	318	280	417	612	1,844
Capital Expenditures	1,750	2,014	2,993	3,116	2,724	12,597
Cash Flow	1,114	1,367	409	813	1,146	4,849
Cash Flow / Revenue	0.08578	0.09122	0.02588	0.04512	0.08176	0.06396
NIBEI / Revenue	0.11812	0.12606	0.11574	0.11738	0.12279	0.11988
Ibbotson Smoothed Cash Flow = \$14,016 x 0.06396 =					\$896.52	
Ibbotson Smoothed Net Income BEI = \$14,016 x 0.11988 =					\$1,680.26	

Capital Expenditures

Capital Expenditures excluding equipment	2,248	2,167	1,991
Acquisition of equipment	745	949	733
Proceeds from sale of equipment financed	-778	-348	-368
Total	2,215	2,768	2,356

Capital Expenditures per WCTL

Capital Expenditures excluding equipment	2,248	2,167	1,991
Acquisition of equipment	745	949	733
Proceeds from sale of equipment financed			
Total	2,993	3,116	2,724

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports.

Cash Flow Calculation - AAR Replication of WCTL

CSX, Corp.	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ in millions)						
Revenue	8,618	9,566	10,030	11,255	9,041	48,510
Net Income	1,145	1,310	1,336	1,365	1,152	6,308
Extraordinary Items	425	0	100	-130	15	410
Depreciation	833	867	890	918	908	4,416
Deferred Taxes	-46	42	272	435	436	1,139
Capital Expenditures	1,136	1,639	1,773	1,740	1,447	7,735
Cash Flow	371	580	625	1,108	1,034	3,718
Cash Flow / Revenue	0.04305	0.06063	0.06231	0.09845	0.11437	0.07664
NIBEI / Revenue	0.08355	0.13694	0.12323	0.13283	0.12576	0.12158
Ibbotson Smoothed Cash Flow = \$9,041 x 0.07664 =						\$692.94
Ibbotson Smoothed Net Income BEI = \$9,041 x 0.12158 =						\$1,099.23

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports.

Cash Flow Calculation - AAR Replication of WCTL

Norfolk Southern	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ In millions)						
Revenue	8,527	9,407	9,432	10,661	7,969	45,996
Net Income	1,281	1,481	1,464	1,716	1,034	6,976
Extraordinary Items	0	0	0	0	0	0
Depreciation	787	750	786	815	845	3,983
Deferred Taxes	80	-8	125	290	338	825
Capital Expenditures	1,025	1,178	1,341	1,558	1,299	6,401
Cash Flow	1,123	1,045	1,034	1,263	918	5,383
Cash Flow / Revenue	0.13170	0.11109	0.10963	0.11847	0.11520	0.11703
NIBEI / Revenue	0.15023	0.15744	0.15522	0.16096	0.12975	0.15167
Ibbotson Smoothed Cash Flow = \$7,969 x 0.11703 =						\$932.63
Ibbotson Smoothed Net Income BEI = \$7,969 x 0.15167 =						\$1,208.62

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports -- no changes.

Cash Flow Calculation - AAR Replication of WCTL

Union Pacific Corp.	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ In millions)						
Revenue	13,578	15,578	16,283	17,970	14,143	77,552
Net Income	1,026	1,606	1,855	2,338	1,898	8,723
Extraordinary Items	0	0	0	0	0	0
Depreciation	1,175	1,237	1,321	1,387	1,444	6,564
Deferred Taxes	320	235	332	547	723	2,157
Capital Expenditures	2,169	2,242	2,496	2,780	2,384	12,071
Cash Flow	352	836	1,012	1,492	1,681	5,373
Cash Flow / Revenue	0.02592	0.05367	0.06215	0.08303	0.11886	0.06928
NIBEI / Revenue	0.07556	0.10309	0.11392	0.13011	0.13420	0.11248
Ibbotson Smoothed Cash Flow = \$14,143 x 0.06928 =					\$979.86	
Ibbotson Smoothed Net Income BEI = \$14,143 x 0.11248 =					\$1,590.80	

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports -- no changes

2009 Cost of Equity Using STB's MSDCF - AAR Replication of WCTL
16 of 18 Growth Rates, Cash Flow Uses Restated Data

Company Year	BNI 2009		CSX 2009		NSC 2009		UNP 2009	
<i>Inputs</i>								
Initial Cash Flow	\$896.52		\$692.94		\$932.63		\$979.86	
Input for Terminal C.F.	\$1,680.26		\$1,099.23		\$1,208.62		\$1,590.80	
Stage One Growth	9.55%		11.55%		12.00%		13.10%	
Stage Two Growth	11.55%		11.55%		11.55%		11.55%	
Stage Three Growth	5.80%		5.80%		5.80%		5.80%	
Year	Val. 12/31	Pres Val.						
1	\$982	\$877	\$773	\$681	\$1,045	\$911	\$1,108	\$982
2	1,076	858	862	669	1,170	889	1,253	983
3	1,179	840	962	658	1,310	869	1,418	985
4	1,291	822	1,073	647	1,468	848	1,603	987
5	1,415	804	1,197	636	1,644	828	1,813	989
6	1,578	801	1,335	625	1,833	806	2,023	977
7	1,760	798	1,489	614	2,045	784	2,256	965
8	1,964	795	1,661	604	2,281	762	2,517	954
9	2,190	792	1,853	593	2,545	741	2,808	942
10	2,443	789	2,067	583	2,839	721	3,132	931
Terminal	78,616	25,397	45,111	12,725	43,798	11,125	75,822	22,545
Sum of Pres. Values		\$33,573.70		\$19,035.18		\$19,285.00		\$32,240.70
Market Value (Input)		\$33,573.70		\$19,035.18		\$19,285.00		\$32,240.70
WCTL Cost of Equity	11.96%		13.49%		14.69%		12.90%	
AAR 5-17-2010 COE	13.10%		13.46%		14.83%		13.02%	
Prev. Yr. Cost of Equity	16.32%		16.79%		19.75%		13.95%	

AAR Replication of WCTL

Equity Market Value on December 31, 2009 and MSDCF Cost of Equity

16 of 18 Growth Rates, Cash Flow Uses Restated Data

Company	Stock Price	Shares Outstanding	Market Value (\$mil)	Weight	Cost of Equity	Weighted Calculation
BNI	\$98.62	340,435,006	\$33,573.7	32.241 %	11.96	3.86
CSX	\$48.49	392,558,925	19,035.2	18.279	13.49	2.47
NSC	\$52.42	367,893,915	19,285.0	18.519	14.69	2.72
UNP	\$63.90	504,549,218	32,240.7	30.961	12.90	3.99
Total		1,605,437,064	\$104,134.6	100.000 %		

Weighted Current Cost of Equity Using MSDCF **13.04 %**

Cost of of Common Equity Capital

Model

Capital Asset Pricing Model	11.39 %
Multi-Stage Discounted Cash Flow	13.04
Cost of Common Equity	12.22 % Average

Capital Structure and Weights

	2009 (Correct)		2009 (Incorrect)	
	Market Value (mil)	Capital Structure Weight	Market Value (mil)	Capital Structure Weight
Debt	\$34,217.9	29.10 %	\$34,224.3	29.11 %
Common Equity	83,349.9	70.90	83,349.9	70.89
Preferred Equity	0.0	0.00	0.0	0.00
Total	\$117,567.8	100.00 %	\$117,574.1	100.00 %

Weighted Current Cost of Capital

	Correct Capital Structure		Incorrect Capital Structure	
	Weight	Current Cost	Weight	Current Cost
Debt	29.10 %	5.72	29.11 %	5.72
Common Equity	70.90	12.22	70.89	12.22
Preferred Equity	0.00	n/a	0.00	n/a
Total	100.00 %		100.00 %	
Weighted Current Cost of Capital		10.32 %		10.33 %

**2009 Median Growth Rates for MSDCF
AAR Replication of WCTL Growth Rates Plus Two Missing Added Back In**

Company	Analyst Growth Rates from IBES December 31						Median
	Rate 1	Rate 2	Rate 3	Rate 4	Rate 5	Rate 6	
BNI	7.1	14.0	12.0	--	--	--	12.00 %
CSX	11.6	15.0	10.0	11.5	13.0	--	11.60
NSC	2.8	15.0	12.0	12.0	12.0	--	12.00
UNP	13.1	10.0	15.0	13.0	15.0	--	13.10

Simple Average of Medians = 12.18 percent.

Two missing growth rates added back in

Cash Flow Calculation - AAR Replication of WCTL

BNSF	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ In millions)						
Revenue	12,987	14,985	15,802	18,018	14,016	75,808
Net Income	1,534	1,888	1,829	2,115	1,721	9,088
Extraordinary Items	0	0	0	0	0	0
Depreciation	1,111	1,176	1,293	1,397	1,537	6,514
Deferred Taxes	219	318	280	417	612	1,844
Capital Expenditures	1,750	2,014	2,993	3,116	2,724	12,597
Cash Flow	1,114	1,367	409	813	1,146	4,849
Cash Flow / Revenue	0.08578	0.09122	0.02588	0.04512	0.08176	0.06396
NIBEI / Revenue	0.11812	0.12606	0.11574	0.11738	0.12279	0.11988
Ibbotson Smoothed Cash Flow = \$14,016 x 0.06396 =					\$896.52	
Ibbotson Smoothed Net Income BEI = \$14,016 x 0.11988 =					\$1,680.26	

Capital Expenditures

Capital Expenditures excluding equipment	2,248	2,167	1,991
Acquisition of equipment	745	949	733
Proceeds from sale of equipment financed	-778	-348	-368
Total	2,215	2,768	2,356

Capital Expenditures per WCTL

Capital Expenditures excluding equipment	2,248	2,167	1,991
Acquisition of equipment	745	949	733
Proceeds from sale of equipment financed			
Total	2,993	3,116	2,724

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports.

Cash Flow Calculation - AAR Replication of WCTL

CSX, Corp.	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ in millions)						
Revenue	8,618	9,566	10,030	11,255	9,041	48,510
Net Income	1,145	1,310	1,336	1,365	1,152	6,308
Extraordinary Items	425	0	100	-130	15	410
Depreciation	833	867	890	918	908	4,416
Deferred Taxes	-46	42	272	435	436	1,139
Capital Expenditures	1,136	1,639	1,773	1,740	1,447	7,735
Cash Flow	371	580	625	1,108	1,034	3,718
Cash Flow / Revenue	0.04305	0.06063	0.06231	0.09845	0.11437	0.07664
NIBEI / Revenue	0.08355	0.13694	0.12323	0.13283	0.12576	0.12158
ibbotson Smoothed Cash Flow = \$9,041 x 0.07664 =						\$692.94
ibbotson Smoothed Net Income BEI = \$9,041 x 0.12158 =						\$1,099.23

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports.

Cash Flow Calculation - AAR Replication of WCTL

Norfolk Southern	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ in millions)						
Revenue	8,527	9,407	9,432	10,661	7,969	45,996
Net Income	1,281	1,481	1,464	1,716	1,034	6,976
Extraordinary Items	0	0	0	0	0	0
Depreciation	787	750	786	815	845	3,983
Deferred Taxes	80	-8	125	290	338	825
Capital Expenditures	1,025	1,178	1,341	1,558	1,299	6,401
Cash Flow	1,123	1,045	1,034	1,263	918	5,383
Cash Flow / Revenue	0.13170	0.11109	0.10963	0.11847	0.11520	0.11703
NIBEI / Revenue	0.15023	0.15744	0.15522	0.16096	0.12975	0.15167
Ibbotson Smoothed Cash Flow = \$7,969 x 0.11703 =						\$932.63
Ibbotson Smoothed Net Income BEI = \$7,969 x 0.15167 =						\$1,208.62

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports -- no changes.

Cash Flow Calculation - AAR Replication of WCTL

Union Pacific Corp.	1	2	3	4	5	Total
	2005	2006	2007	2008	2009	
(\$ In millions)						
Revenue	13,578	15,578	16,283	17,970	14,143	77,552
Net Income	1,026	1,606	1,855	2,338	1,898	8,723
Extraordinary Items	0	0	0	0	0	0
Depreciation	1,175	1,237	1,321	1,387	1,444	6,564
Deferred Taxes	320	235	332	547	723	2,157
Capital Expenditures	2,169	2,242	2,496	2,780	2,384	12,071
Cash Flow	352	836	1,012	1,492	1,681	5,373
Cash Flow / Revenue	0.02592	0.05367	0.06215	0.08303	0.11886	0.06928
NIBEI / Revenue	0.07556	0.10309	0.11392	0.13011	0.13420	0.11248
Ibbotson Smoothed Cash Flow = \$14,143 x 0.06928 =					\$979.86	
Ibbotson Smoothed Net Income BEI = \$14,143 x 0.11248 =					\$1,590.80	

Data retrieved from 2007, 2008, and 2009 10-K reports, with most recent 10-K over-riding any differences from earlier 10-K reports -- no changes.

**2009 Cost of Equity Using STB's MSDCF
AAR Replication of WCTL Plus Two Missing Growth Rates Used**

18 of 18 Growth Rates, Cash Flow Uses Restated Data

Company Year	BNI 2009		CSX 2009		NSC 2009		UNP 2009	
<i>Inputs</i>								
Initial Cash Flow	\$896.52		\$692.94		\$932.63		\$979.86	
Input for Terminal C.F.	\$1,680.26		\$1,099.23		\$1,208.62		\$1,590.80	
Stage One Growth	12.00%		11.60%		12.00%		13.10%	
Stage Two Growth	12.18%		12.18%		12.18%		12.18%	
Stage Three Growth	5.80%		5.80%		5.80%		5.80%	
Year	Val. 12/31	Pres Val.						
1	\$1,004	\$892	\$773	\$681	\$1,045	\$910	\$1,108	\$981
2	1,125	887	863	668	1,170	887	1,253	981
3	1,260	882	963	656	1,310	865	1,418	982
4	1,411	877	1,075	645	1,468	844	1,603	983
5	1,580	872	1,200	633	1,644	823	1,813	983
6	1,772	869	1,346	625	1,844	804	2,034	976
7	1,988	865	1,509	617	2,068	786	2,282	969
8	2,230	862	1,693	609	2,320	767	2,560	961
9	2,502	858	1,899	601	2,602	750	2,871	954
10	2,806	855	2,131	593	2,919	732	3,221	947
Terminal	81,584	24,856	45,629	12,707	44,319	11,117	76,606	22,524
Sum of Pres. Values		\$33,573.70		\$19,035.18		\$19,285.00		\$32,240.70
Market Value (Input)		\$33,573.70		\$19,035.18		\$19,285.00		\$32,240.70
WCTL Cost of Equity	12.62%		13.64%		14.83%		13.02%	
AAR 5-17-2010 COE	13.10%		13.46%		14.83%		13.02%	
Prev. Yr. Cost of Equity	16.32%		16.79%		19.75%		13.95%	

AAR Replication of WCTL
With Two Missing Growth Rates Added Back In
Equity Market Value on December 31, 2009 and MSDCF Cost of Equity

18 of 18 Growth Rates, Cash Flow Uses Restated Data

Company	Stock Price	Shares Outstanding	Market Value (\$mil)	Weight	Cost of Equity	Weighted Calculation
BNI	\$98.62	340,435,006	\$33,573.7	32.241 %	12.62	4.07
CSX	\$48.49	392,558,925	19,035.2	18.279	13.64	2.49
NSC	\$52.42	367,893,915	19,285.0	18.519	14.83	2.75
UNP	\$63.90	504,549,218	32,240.7	30.961	13.02	4.03
Total		1,605,437,064	\$104,134.6	100.000 %		

Weighted Current Cost of Equity Using MSDCF **13.34 %**

Cost of of Common Equity Capital

Model

Capital Asset Pricing Model	11.39 %
Multi-Stage Discounted Cash Flow	13.34
Cost of Common Equity	12.37 % Average

Capital Structure and Weights

	2009 (Correct)	
	Market Value (mil)	Capital Structure Weight
Debt	\$34,217.9	29.10 %
Common Equity	83,349.9	70.90
Preferred Equity	0.0	0.00
Total	\$117,567.8	100.00 %

Weighted Current Cost of Capital

	Correct Capital Structure Weight	Current Cost	Calculation
Debt	29.10 %	5.72	1.66
Common Equity	70.90	12.37	8.77
Preferred Equity	0.00	n/a	
Total	100.00 %		
Weighted Current Cost of Capital			10.43 %