

UNITED STATES OF AMERICA  
SURFACE TRANSPORTATION BOARD

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DECISION

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IN THE MATTER OF: :  
WESTERN COAL TRAFFIC LEAGUE- : Docket No.  
PETITION FOR DECLARATORY ORDER. : FD 35506  
and MISSOURI PACIFIC RAILROAD :  
COMPANY :  
:

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Thursday,  
March 22, 2012

Surface Transportation Board  
Suite 120  
395 E Street, S.W.  
Washington, D.C.

The above-entitled matter came on  
for hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

DANIEL R. ELLIOTT, III, Chairman  
FRANCIS P. MULVEY, Vice Chairman  
ANN D. BEGEMAN, Commissioner

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P-R-O-C-E-E-D-I-N-G-S

9:31 a.m.

CHAIRMAN ELLIOTT: Good morning, everyone. Welcome. Today we'll be hearing oral presentations in this public hearing on a Petition for a Declaratory Order filed by the Western Coal Traffic League, in STB docket number FD 35506.

The proceeding concerns the impact that Berkshire Hathaway's acquisition of the BNSF Railway Company on certain regulatory determinations.

Berkshire paid \$43 billion for the 2010 acquisition of BNSF, which triggered an \$8.1 billion write-up in the railroad's net investment base under purchase price accounting rules.

This public hearing will be presented through a series of six panels. In its February 15th, 2012 Order announcing the Public Hearing in this case, the Board asked for Notices of Intent to Participate and asked

1 each party to include a summary of the  
2 intended testimony, not to exceed three pages.

3 On March 12th, the Board issued a  
4 further order providing the roster of those  
5 who have requested to participate, together  
6 with their allocated times on the six panels.

7 In an effort to move things along,  
8 the Board members will not be making lengthy  
9 opening remarks this morning. But I wanted to  
10 cover a few procedural matters before we  
11 begin.

12 All witnesses are encouraged to use  
13 their hearing time to call attention to the  
14 points they believe are particularly  
15 important. Witnesses should present their  
16 oral statement and be prepared to answer  
17 questions from the Board afterwards.

18 Speakers, please note the timing  
19 lights are in front of me. You will see a  
20 yellow light when you have one minute  
21 remaining, and a red light when your time has  
22 expired.

1           The yellow one minute light will be  
2           accompanied by a single chime and the red  
3           light signifying that your time has expired  
4           will be accompanied by two chimes.

5           Please keep to the time that you  
6           have been allotted. When you see the red  
7           light and hear the double chime, please finish  
8           your thought and take a seat.

9           In addition, just a reminder to  
10          everyone to please turn off their cell phones.  
11          Also, as a matter of information, our cameras  
12          are not acting perfectly today.

13          So while they can focus in on the  
14          board members, they won't be able to focus in  
15          on you. So everyone's probably going to be on  
16          the camera when the panels are speaking.

17          So just so you know that and aren't  
18          doing anything funny while the cameras are on,  
19          because you will be viewed nationally. And I  
20          kind of prefer that we weren't having close  
21          ups either. But we can't get rid of that.  
22          Anyhow, we are waiting for Senator Franken to

1       come. I heard he's going to be here  
2       momentarily.

3               So why don't we just, before we get  
4       started, because I think our first panelist  
5       after that is quite lengthy, WCTL. And so I  
6       would hate to get started into that.

7               So why don't we have someone check  
8       and just see what the status is.

9               VICE CHAIRMAN MULVEY: Is he here?

10              CHAIRMAN ELLIOTT: It's perfect  
11       timing.

12              SENATOR FRANKEN: Well, thank you.

13              CHAIRMAN ELLIOTT: Senator. Welcome  
14       Senator Franken. You have the floor, so go  
15       ahead.

16              SENATOR FRANKEN: Thank you so much,  
17       Chairman Elliott and members of the Board.  
18       Thank you for holding this hearing on the  
19       acquisition premium that Berkshire Hathaway  
20       paid to acquire BNS Railroad in 2010.

21              I also want to thank you for being  
22       so flexible with your schedule and by allowing

1 me to testify before your other witnesses this  
2 morning. I really appreciate that.

3 Rail to rail competition is an issue  
4 that I care about tremendously. And as you  
5 may recall, I was before you last June to urge  
6 the Board to do more to spur competition in  
7 this very concentrated industry.

8 I routinely hear from shippers in  
9 Minnesota that they do not feel that there are  
10 real choices when it comes to shipping their  
11 goods by rail, and they don't feel they get a  
12 fair shake on the major railroads.

13 Whether you're talking about our  
14 agricultural producers, electric utilities, or  
15 manufacturers, they all depend on rail for  
16 shipping.

17 And, as I said before, I think it's  
18 critical that we have a competitive rail  
19 industry that provides affordable rates and  
20 reliable service for America's shippers, both  
21 to keep jobs here in America, and to keep  
22 American industries competitive in the global

1 marketplace.

2 This issue is deeply personal to me,  
3 as the Board knows. When I was here in June,  
4 I told you about the first hand experience of  
5 my family; about how much the power of a  
6 railroad has to make or break a company.

7 I told you about my dad, who moved  
8 our family from New Jersey to a little town in  
9 southern Minnesota, Albert Lee, Minnesota when  
10 I was four years old to start a quilting  
11 factory.

12 He picked Albert Lee because the  
13 railroad went through Albert Lee. But  
14 unfortunately, to his dismay, learned that the  
15 railroad, while went through Albert Lee  
16 wouldn't stop, basically they shook him down.

17 And the factory failed in two years.  
18 And we ended up moving up to the Twin Cities.  
19 I tell that story, which is now actually 55  
20 years old, because I don't think much has  
21 changed for captive shippers like my dad over  
22 the past 55 years.

1           If anything, things have only gotten  
2 worse. BNSF is the single largest railroad  
3 company in the United States. It controls 37  
4 percent of the rail industry and owns 23,000  
5 miles of track.

6           And for many shippers in Minnesota,  
7 BNSF is their only option for getting their  
8 goods and services in and out of the state.

9           According to a recent report by  
10 Escalation Consultants, 73 percent of  
11 Minnesota's 800 rail stations are served by a  
12 single railroad. And nationally, the numbers  
13 are even worse.

14           Seventy eight percent of all rail  
15 freight stations or 21,466 stations in the  
16 United States are served by a single railroad.

17           Now I realize this isn't the focus  
18 of your hearing today, but I think it is  
19 important to highlight, because for many  
20 shippers, especially farmers in my state, rail  
21 is their only option.

22           It isn't realistic for those farmers

1 to load trucks up with oats or beets or corn  
2 and transport those products across the  
3 country. That may work for short distances,  
4 but rail is really the only option for long  
5 distance shipping of agriculture.

6 And that means those shippers are,  
7 for all intents and purposes, captive to the  
8 railroads, even if the Board doesn't consider  
9 them to be captive for purposes of challenging  
10 their rates.

11 Now what does that have to do with  
12 what Berkshire Hathaway paid for BNSF? These  
13 two issues are linked, because how Berkshire  
14 Hathaway accounts for its acquisition premium  
15 will directly impact when and how captive  
16 shippers can challenge rates before the Board.

17 And there are many shippers like the  
18 Minnesota farmers that I mentioned who may be  
19 completely out of luck and unable to challenge  
20 rate increases, because they aren't considered  
21 captive by your standards.

22 I led a bi-partisan letter about

1       this issue with nine of my colleagues back in  
2       March of last year, because I am concerned  
3       that Berkshire Hathaway may be able to pass on  
4       this acquisition premium, roughly \$8 billion,  
5       to its customers in the form of higher rates.

6               Now I understand that the Board has  
7       previously allowed railroads to include the  
8       acquisition premium that was paid when  
9       calculating the total assets of a company  
10      following a merger.

11             But that was only when two railroad  
12      companies were merging or one company was  
13      acquiring another rail company. In this  
14      instance, you have a major capital investment  
15      fund acquiring a railroad company.

16             There is no possibility of  
17      generating new rail efficiencies with this  
18      merger. And hence, there's no reason why this  
19      premium should be calculated into BNSF's asset  
20      base.

21             If this premium is included in the  
22      railroad's asset base, I fear it will send a

1 message to the railroads that they can  
2 artificially inflate their assets to get  
3 around the Board's rules.

4 And I fear it will send the message  
5 to shippers that the Board does not care about  
6 them, and isn't worried that they may face  
7 higher rates.

8 I also can't leave here today  
9 without noting for the record that on the date  
10 that Berkshire Hathaway paid an \$8 billion  
11 premium, more than 30 percent above the  
12 trading price of BNSF's shares, BNSF was  
13 considered by this Board to be revenue  
14 inadequate.

15 If Berkshire Hathaway is able to  
16 amass capital to pay such a hefty premium, how  
17 could the Board consider this company to be  
18 making less than adequate revenues? That  
19 makes no sense to me.

20 And it troubles me that the Board  
21 still considers BNSF to be revenue inadequate  
22 today. This is even after Warren Buffett has

1 sent shareholder letters in 2011 and 2012  
2 noting the strength of BNSF's financial  
3 performance over the last two years.

4 This is not right. You don't need  
5 to be an economist or have Warren Buffett's  
6 financial expertise to see that. Most  
7 shippers have absolutely zero bargaining power  
8 to negotiate with the railroads when they face  
9 a rate increase.

10 And very few are able, today, to  
11 meet the incredibly high threshold of 180  
12 percent of revenue to variable costs that the  
13 Board requires to bring a rate case.

14 If this acquisition premium can be  
15 folded into BNSF's assets, an even smaller  
16 number of rate customers will be able to bring  
17 an action or make a credible threat that they  
18 plan to challenge the rate.

19 Most shippers facing this situation  
20 don't want to say anything publically because  
21 of fear of retaliation, and realize it would  
22 be a fight between David and Goliath.

1           In my view, that's one of the most  
2       telling signs that we do not have a  
3       competitive rail industry in America today.  
4       And that is why I wanted to come here today to  
5       make the case on their behalf.

6           It is the responsibility of this  
7       Board to protect shippers from anti-  
8       competitive practices in the rail industry.  
9       Congress has given you broad authority and the  
10      flexibility to take action.

11          It's time to examine the STB's  
12      policies and make this small change to protect  
13      shippers from unreasonable rate hikes.

14          Thank you again for the opportunity  
15      to testify and for making time for me and  
16      allowing me to testify now. I hope to see the  
17      Board take action very soon on this issue.  
18      Thank you.

19                 CHAIRMAN ELLIOTT: Thank you,  
20      Senator Franken. Thank you for taking the  
21      time out of your busy schedule to appear here  
22      today. We appreciate it.

1                   SENATOR FRANKEN:  It's always my  
2                   pleasure.  Thank you.

3                   CHAIRMAN ELLIOTT:  The next panel  
4                   can come up.  We're going to also do some  
5                   opening statements from the other Board  
6                   members if they have any.  I kind of rushed  
7                   into the Senator's presentation without doing  
8                   that.

9                   VICE CHAIRMAN MULVEY:  Thank you,  
10                  Dan.

11                  CHAIRMAN ELLIOTT:  You can go ahead,  
12                  Frank, yes.

13                  VICE CHAIRMAN MULVEY:  Very briefly,  
14                  I want to thank our witnesses for coming  
15                  today.  This is a very complex case and we  
16                  eagerly await the information that we're going  
17                  to receive from the various panel members.

18                  It involves highly technical  
19                  accounting issues.  And we are concerned, as  
20                  Senator Franken mentioned, that shippers are  
21                  given equitable consideration in this.

22                  And I must say that both sides of

1 the argument submitted well pled statements,  
2 strong well pled statements. We have read  
3 those statements and taken them under  
4 advisement.

5 And we expect to see those fleshed  
6 out a little bit by the testimonies. This is  
7 an issue that somewhat revolves around the  
8 theoretical correct thing to do versus the  
9 practical impact of what we do.

10 One of our former Board members was  
11 famous for saying that there's a very big  
12 difference between what the Board can do and  
13 what the Board should do.

14 And we want to make sure that we do  
15 that which is in the best interests of both  
16 shippers and the railroad, and is consistent  
17 with what the Board has done in the past.

18 I look forward to hearing the  
19 testimony from all the panelists. I expect  
20 that that testimony will be of great  
21 assistance to the Board in rendering its  
22 decision. Thank you.

1 CHAIRMAN ELLIOTT: Thank you, Vice  
2 Chairman. Next, we'll hear from the panel  
3 composed of representatives from Western Coal  
4 Traffic League.

5 You have been allotted 45 minutes  
6 for this panel, and I understand you have  
7 reserved 15 minutes for rebuttal after the  
8 other witnesses present their comments. So  
9 you can begin your presentation at this time.

10 MR. LESEUR: Thank you, Chairman  
11 Elliott. Chairman Elliott, Vice Chairman  
12 Mulvey, Commissioner Begeman, my name is John  
13 Leseur. I'm accompanied here today by Tom  
14 Crowley and Dr. John Wilson.

15 We're appearing here today on behalf  
16 of the Western Coal Traffic League, the  
17 American Public Power Association, Edison  
18 Electric Institute, the National Rural  
19 Electric Cooperative Association, Western  
20 Fuels Association, Basin Electric Power  
21 Cooperative, and the National Association of  
22 Regulatory Utility Commissioners.

1           Each of us has a short statement.  
2           We've tried to put together sort of a package  
3           presentation. We'll see how that goes. I'm  
4           going to lead off followed by Mr. Crowley and  
5           Dr. Wilson.

6           As we stated in our papers, we  
7           believe this case raises a fundamental  
8           regulatory question. And that is, should  
9           BNSF's captive shippers pay higher rates  
10          simply because BNSF's ownership has changed  
11          hands?

12          The nation's coal shippers, who we  
13          represent here today, submit the answer to  
14          that question as an emphatic no. And we're  
15          not alone.

16          Our views are shared by all other  
17          shipper associations participating in this  
18          proceeding, by the National Association of  
19          Regulatory Utility Commissions who represent  
20          the interests of public utility regulatory  
21          commissions in all 50 states.

22          We're joined by United States

1 Department of Agriculture and by 11 United  
2 States Senators who have submitted comments on  
3 this proceeding.

4 The case that we've presented to the  
5 Board from our vantage point is fairly  
6 straightforward and has five component parts.

7 First, our evidence shows that  
8 Berkshire paid a substantial premium to  
9 acquire BNSF. And for regulatory purposes,  
10 that premium equals approximately \$8.1 billion  
11 dollars.

12 Secondly, our evidence shows that  
13 the Board's inclusion of this \$8.1 billion  
14 premium in BNSF's URCS and in the net  
15 investment base the Board uses to determine  
16 BNSF's revenue adequacy will automatically  
17 result in higher rates on BNSF's captive  
18 traffic.

19 Third, we show that it's  
20 fundamentally unfair for BNSF's captive  
21 shippers rates to increase simply because  
22 Berkshire paid a premium to acquire BNSF.

1           Our fairness argument is simple and  
2           straightforward. This transaction that is  
3           structured by Berkshire offers no benefits to  
4           BNSF's customers in the form of improved  
5           service or any other benefits.

6           Instead, captive shippers are simply  
7           being asked to pay more for the same service  
8           they received before the acquisition. And we  
9           submit that it's fundamentally unfair.

10          Conversely, excluding the premium,  
11          we believe is not unfair to BNSF's new owners,  
12          Berkshire Hathaway.

13          As Senator Franken referred to,  
14          Berkshire's publically reporting they're  
15          already earning billions of dollars in their  
16          investment in BNSF. It's been a very good  
17          investment for them.

18          And our position is that Berkshire  
19          Hathaway does not need to earn more at the  
20          expense of BNSF's captive shippers.

21          And we believe that's particularly  
22          true when, you know, for electric utilities

1       who are captive shippers and others, the folks  
2       that end up eventually paying the premium are  
3       utility rate payers, you know, farmers, small  
4       businesses.

5               And as Department of Agriculture has  
6       succinctly put it in their comments, "It is  
7       unfair to expect American farmers in rural  
8       communities to pay higher rates which reduce  
9       their real incomes because a large acquisition  
10      premium was paid by BNSF."

11              Fourth, our evidence shows that no  
12      other public utility regulator in the country  
13      would put -- permit a pass through of an  
14      acquisition premium on the facts of this case.

15              In the public utility sector,  
16      premium pass dues are permitted only if the  
17      acquiring party can show the overall result to  
18      the customer would be lower, not higher rates.

19              And fifth, we show the board has the  
20      legal authority to remove the premium from  
21      BNSF's URCS and from BNSF's net investment  
22      base for revenue accuracy purposes.

1           Our case also addresses and responds  
2           to what we find are BNSF's principal arguments  
3           in the case. And BNSF's number one argument  
4           is this is an accounting case, and accounting  
5           rules should govern.

6           It's fairly straight forward, in  
7           their view you apply a GAAP, the Western Coal  
8           Traffic League loses. What we attempted to  
9           show in our filings is this is not an  
10          accounting case.

11          It's really the impact of the  
12          premium on rates, because the way the Board  
13          sets rates these days with variable costs,  
14          including the premium, of the variable cost  
15          standards should apply here and that we should  
16          be using a regional rate, it should have a  
17          reasonable accounting.

18          Secondly, BNSF sites a lot of  
19          precedents. They point out that the many  
20          mergers and other acquisitions this board and  
21          the ICC consider an acquisition premium was  
22          paid when the merger was approved or the

1 acquisition.

2 And that was flowed through into the  
3 merge carriers URCS and into their revenue  
4 adequacy rate bases. We've endeavored to show  
5 that our facts in these cases are materially  
6 different from the cases we have here. In all  
7 those other merger cases, the transactions  
8 were approved because they were found to be in  
9 the public interest.

10 And why were they found to be in the  
11 public interest? Well, the board concluded  
12 that the merge carriers had reduced costs,  
13 reduced cost was passed on to the shippers in  
14 the form of lower rates and better service.

15 By contrast, in this case, inclusion  
16 of the premium in the rate base is not offset  
17 by any benefits. There aren't merger  
18 synergies in result of the higher, not lower  
19 rates.

20 And finally, BNSF repeats throughout  
21 its filings this case is really much ado about  
22 nothing. That in the end very few, if any,

1 shippers will be adversely impacted by  
2 including the premium in BNSF's URCS and  
3 revenue adequacy rate base.

4 We show in our filing that's not the  
5 case. Very large segment of the BNSF's  
6 traffic case is potentially subject to STB  
7 rate regulations.

8 Yet the shippers routinely rely on  
9 the STB standards and attempt to negotiate a  
10 deals with the railroads to avoid coming  
11 before this agency.

12 And finally, we submit that, you  
13 know, if in fact, BNSF is correct, why are  
14 they fighting so hard and why don't they just  
15 stipulate to the relief that we request and we  
16 believe the answer's obvious.

17 That what's really going on here,  
18 both sides know that inclusion of the premium  
19 has an impact and that's why we're all here  
20 this morning.

21 That's all I have for my opening  
22 statement. Mr. Crowley will follow this with

1 details and then Dr. Wilson.

2 MR. CROWLEY: Good morning. As John  
3 was mentioning briefly with regards to the  
4 agreement and the handling of the Berkshire  
5 Hathaway acquisition where the parties agreed  
6 that BNSF's net adjustment for regulatory  
7 purposes due to the acquisition premium will  
8 increase by 8.1 billion, and annual  
9 depreciation will increase by 128 billion in  
10 2010.

11 The parties agree that BNSF's URCS  
12 variable costs will increase. The parties  
13 agree that BNSF's net investments for revenue  
14 adequacy purposes will increase.

15 The parties agree that it is a  
16 simple task for the Board's staff to adjust  
17 BNSF's URCS to remove the premium. And the  
18 parties agree that there were no acquisition  
19 synergies that will offset the premium.

20 I will now focus on three areas  
21 where the BNSF and the shippers are not in  
22 agreement. First, whether inclusion of the

1       Berkshire premium and BNSF's URCS will result  
2       in higher rates for captive BNSF shippers.

3               Whether inclusion of the premium and  
4       BNSF's URCS is required under the board's  
5       merger precedents. And whether inclusion of  
6       the premium and BNSF's URCS is required by  
7       GAAP or concepts of economic accuracy.

8               I've developed a number of slides.  
9       The first one is on the screen. The first  
10      slide demonstrates the acquisition premium  
11      with the increased BNSF's URCS variable costs,  
12      which will increase the jurisdictional  
13      threshold for captive movements.

14              The evidence that I submitted in  
15      this case, I made a demonstration of a typical  
16      1,200 mile grain movement. And for that  
17      movement of the jurisdictional threshold  
18      increased by 40 cents per ton.

19              I did the same analysis for a 1,000  
20      mile coal movement. And the jurisdictional  
21      threshold increased by 58 cents per ton.

22              We also evaluated the number of BNSF

1 captive shippers that can bring cases before  
2 the Board and it decreases significantly.

3 My next slide demonstrates maximum  
4 rates for those shippers for the rate  
5 restriction will increase.

6 In the Western Fuels Basin Electric  
7 Coal case, the rate prescription was based on  
8 the stand alone cost constraint.

9 Over the remaining life of the STB's  
10 rate prescription, WE Basin's total  
11 transportation charges will increase by \$25.1  
12 million if the acquisition premium is  
13 included.

14 Another recent rate prescription was  
15 in the Arizona Power Case, or AEPCO. And  
16 their rate prescription was based on the  
17 jurisdictional threshold.

18 Over the remaining life of the STB  
19 rate prescription, AEPCO's total  
20 transportation charges will increase by  
21 between \$1.8 and \$4.1 million, depending upon  
22 the origin that the coal comes from.

1           The inclusion of the premium will  
2           also impact rates set under the simplified  
3           stand alone cost procedures and can reduce  
4           relief based on the 3 benchmark standards by  
5           over 50 percent.

6           Next, take a look at the STB's  
7           revenue accuracy calculation. The STB  
8           determined that 2010 after tax cost of capital  
9           would equal 11.03 percent, which excluded for  
10          the first time consideration of BNSF.

11          If the premium is excluded, BNSF's  
12          2010 ROI equals 10.66 percent. If a partial  
13          impact premium is included, BNSF's 2010 ROI  
14          equals 9.22 percent. If the acquisition  
15          premium was fully incorporated, as it will be  
16          in 2011, BNSF's --

17                 CHAIRMAN ELLIOTT: Mr. Crowley?

18                 MR. CROWLEY: Yes?

19                 CHAIRMAN ELLIOTT: Do you mind if we  
20                 hold on one second? Apparently we're having  
21                 some issues with the court reporter being able  
22                 to hear everyone. And I think we're required

1 to have some form of record.

2 So can we just take a short break  
3 here and see if we can resolve this matter?  
4 Sorry.

5 (Whereupon, the foregoing matter  
6 went off the record at 9:58 a.m. and went back  
7 on the record at 10:02 a.m.)

8 MR. CROWLEY: Did I break the  
9 microphone?

10 CHAIRMAN ELLIOTT: Okay? Okay. I  
11 apologize for that. That's one of the bad  
12 things about technology, as many good things  
13 as there are.

14 So why don't we commence. We will  
15 obviously not penalize you for that delay. Go  
16 ahead.

17 MR. CROWLEY: I'll try not to break  
18 anything else.

19 CHAIRMAN ELLIOTT: The chairs, too,  
20 we had a problem with that last time.

21 MR. CROWLEY: When we left our  
22 story, BNSF's 2010 ROI was at 9.22 percent.

1 If the acquisition premium is fully  
2 incorporated as it will be in 2011, BNSF's  
3 2010 ROI would equal 8.05 percent.

4 I will now turn to a discussion of  
5 whether inclusion of the premium in BNSF's  
6 URCS is required under Board merger precedent.

7 The Board and its predecessor, the  
8 ICC, approved all major mergers since 1980  
9 because they believed the mergers would  
10 produce deficiencies.

11 They would be passed to the shippers  
12 in the form of lower rates and improved  
13 service.

14 I've put together this table that's  
15 on the screen that shows the merger synergies  
16 as well as the acquisition premium that  
17 resulted from each of the past four mergers  
18 and compare those numbers to what we see in  
19 the Berkshire Hathaway acquisition of BNSF.

20 As you can see by looking at each of  
21 the mergers, there were considerable synergies  
22 that influenced the STB and/or ICC's thinking.

1 And the years to recover those synergies or  
2 those premiums based on those synergies was  
3 rather low, four years or less.

4 When we come to the instant case, we  
5 see the largest acquisition premium of any of  
6 the recent mergers by a factor of over two,  
7 and we see absolutely no projected cost  
8 synergies to offset that premium.

9 The last point that I would like to  
10 discuss is whether inclusion of the premium in  
11 BNSF's URCS is required by GAAP or concepts of  
12 economic accuracy.

13 While GAAP may require inclusion of  
14 the acquisition premium for financial  
15 reporting, it's inclusion is not required for  
16 rate-making purposes. To support this  
17 proposition, I extracted three quotes from the  
18 written testimony in this proceeding.

19 The first is from BNSF witness Weil:  
20 recognized that GAAP doesn't require the STB  
21 to use any accounting convention for  
22 regulatory purposes.

1 Dr. Verecchia agreed that GAAP is  
2 not primarily directed to regulation. So it  
3 should not be refined for rate making  
4 purposes.

5 These portions of the written record  
6 support my testimony where I stated pre-  
7 acquisition costs reflect economic value of  
8 assets devoted to public use while evaluation  
9 after the Berkshire acquisition reflects the  
10 new market value of those assets.

11 The issue for the STB when  
12 developing variable costs for regulatory  
13 purposes can not be resolved by an examination  
14 of which cost is more accurate because both  
15 versions of cost are accurate.

16 Instead, the STB must look at the  
17 purpose of the valuation, and the impact on  
18 the shippers due to an artificial increase in  
19 cost.

20 GAAP does not mandate how rates are  
21 to be set because both the pre-acquisition  
22 costs and the new market value of assets are

1       theoretically accurate.

2               Inclusion of the premium in BNSF's  
3       URCS variable cost calculation is a policy  
4       issue for the board to resolve. Thank you.

5               MR. WILSON: Mr, Chairman,  
6       Commissioners, my name is John Wilson. By way  
7       of background, I'm an economist that  
8       specializes in public utility rate regulation.

9               I received by bachelors and masters  
10       degrees many years ago from the University of  
11       Wisconsin, and my Ph.D. in economics from  
12       Cornell University.

13               Early in my professional career, I  
14       served as the Chief of the Division of  
15       Economic Studies of the Federal Power  
16       Commission, which is now the Federal Energy  
17       Regulatory Commission, or FERC.

18               I have participated in several  
19       hundred proceedings before FERC and state  
20       regulatory agencies involving public utility  
21       rates, competition, and service issues  
22       including many proceedings that address the

1 regulatory treatment of acquisition premiums.

2 I have submitted two detailed  
3 written verified statements in this proceeding  
4 on behalf of the Western Coal Traffic League,  
5 National Association of Regulatory Utility  
6 Commissioners, The Edison Electric Institute  
7 and the other parties noted by Mr. Leseur.

8 This morning, I would like to  
9 emphasize four of my principle conclusions.

10 First, no public utility regulator, such as  
11 FERC or a state utility commission would  
12 permit a pass through of an acquisition  
13 premium on the facts in this case, which  
14 involves a very large acquisition premium and  
15 no offsetting consumer benefits.

16 This result is rooted in fundamental  
17 principals of public utility regulation, which  
18 were aptly summarized by FERC in its 1982  
19 Williston Pipeline decision which stated a  
20 mere change in ownership should not result in  
21 an increase in the rate for service if the  
22 basic service itself remains unchanged.

1           A good and recent example of the  
2           application of this rule came in 2006 when  
3           Berkshire Hathaway, through one of it's  
4           subsidiary companies acquired PacifiCorp,  
5           which is a major electric utility in the  
6           Northwestern United States.

7           This transaction, like Berkshire's  
8           Acquisition of BNSF, was one where Berkshire  
9           paid a substantial premium for the acquired  
10          company.

11          And, as Berkshire conceded, the  
12          transaction offered no synergies or benefits  
13          to PacifiCorp's customers in the form of  
14          reduced costs and rates. It was merely a  
15          transfer of ownership.

16          In that case, Berkshire acknowledged  
17          that governing principals of utility rate  
18          regulation precluded its pass through of the  
19          premium to PacifiCorp's customers and  
20          stipulated that it would not seek such a pass  
21          through.

22          Second, BNSF has argued that

1 principals of public utility law do not apply  
2 because of differences between public utility  
3 rate regulation and railroad rate regulation.

4 This is not the case. Rate  
5 regulation, be it of railroads, electric  
6 utilities, or other regulated entities is  
7 premised on the principle that captive  
8 customers should pay reasonable rates set by  
9 independent regulators serving the public  
10 interest.

11 Under this standard, the principle  
12 that captive customers rates should not  
13 increase solely due to a change in the  
14 company's ownership can and should apply to  
15 regulation of both railroad and public utility  
16 rates.

17 BNSF has also argued that public  
18 utility regulators do not permit premium pass  
19 throughs because of circularity concerns. By  
20 circularity, they mean cases where an entity  
21 buys a utility for an inflated above market  
22 price.

1           That price gets reflected in rate  
2       base. The utility customers then pay inflated  
3       prices, which lead to increased profits, which  
4       lead to another round of inflated purchase  
5       prices, and so on, and so on.

6           I'm sure that all public utility  
7       regulators would reject an acquisition if they  
8       determine the price paid was gained in that  
9       manner. But that is not the issue here.

10          The point I want to emphasize is  
11       that public utility regulators routinely  
12       reject the pass through of premiums even where  
13       the acquisition transaction is arms length and  
14       the price paid is not gained in any way.

15          The guiding regulatory principle is  
16       to protect all captive customers from paying  
17       higher prices simply because the ownership of  
18       the utility has changed hands.

19          Berkshire's acquisition of  
20       PacifiCorp illustrates this point well. There  
21       was no allegation in that case that Berkshire  
22       paid a gained or inflated price to acquire

1 PacifiCorp, and no circularity concerns were  
2 raised.

3 Berkshire did not seek a premium  
4 pass through in that case because the  
5 transaction offered no offsetting benefits to  
6 PacifiCorp's customers, which is the governing  
7 test.

8 Third, it appears to me that this  
9 Board and its predecessor, the ICC, have  
10 decided prior mergers and acquisitions in a  
11 manner that conforms to public utility law  
12 principles.

13 As I understand it, when the ICC and  
14 the STB have approved rail mergers involving  
15 acquisition premiums, they have done so  
16 because they believe that the transactions  
17 would ultimately result in lower rates and  
18 better service to captive customers due to  
19 cost reductions resulting from these  
20 acquisitions or consolidations.

21 That is a standard similar to the  
22 one that FERC and state regulatory agencies

1 have applied in permitting premium pass  
2 throughs when that has occurred.

3 Berkshire's acquisition of BNSF is  
4 not like these past transactions because the  
5 \$8.1 billion premium Berkshire paid will not  
6 be offset by any consolidation cost  
7 reductions, and as Mr. Crowley has shown, will  
8 lead to higher rates for BNSF captive  
9 customers.

10 Exclusion of the premium under these  
11 facts appears to me to be entirely consistent  
12 with the board's actions in approving the pass  
13 through of premiums in other cases where the  
14 board concluded customer rates would be  
15 reduced as a result of the transaction.

16 Fourth, BNSF has argued that  
17 exclusion of the acquisition premium from its  
18 regulatory costs conflicts with generally  
19 accepted accounting principles, GAAP, which  
20 are concepts of accounting accuracy.

21 These arguments have never been  
22 accepted by FERC or other public utility

1 regulators in setting reasonable rates.

2 As regards acquisition premiums, the  
3 focus of FERC and public utility regulators is  
4 reaching a fair result for captive customers,  
5 not on rigid adherence to GAAP accounting  
6 principles.

7 Similarly, if BNSF's accounting  
8 accuracy points are to be believed, FERC and  
9 state regulators are calculating economically  
10 inaccurate costs when they exclude premiums  
11 from regulatory rate bases.

12 Of course, excluding a premium does  
13 not make the resulting investment base  
14 inaccurate. Rather, it reflects an accurate  
15 measure of a fair investment base for rate  
16 regulation purposes.

17 Finally, I point out that my views  
18 are shared by the National Association of  
19 Regulatory Utility Commissioners, an  
20 organization that represents the collective  
21 interests of all state public utility  
22 commissions.

1           NARUC agrees that inclusion of the  
2           premium in BNSF's regulatory costs conflicts  
3           with basic principles of public utility  
4           regulation and it has urged the Board to  
5           exclude the Berkshire premium from BNSF's  
6           regulatory costs. Thank you.

7           CHAIRMAN ELLIOTT: Anything further?  
8           Okay, now we will begin to ask questions, and  
9           then we'll go from Commissioner to  
10          Commissioner.

11          I'll start out on this panel. Just  
12          as an attorney that used to practice, if I  
13          took a look at this case from your standpoint,  
14          you know, I would think there would be some  
15          significant hurdle to overcome here, because  
16          we have some pretty strong statutory language  
17          which says that we should use GAAP to the  
18          maximum extent practical.

19          We have extensive precedent here in  
20          the case. And then we have, I guess,  
21          positions that, over time, have flipped. Not  
22          just you, but the railroads also with respect

1 to this issue.

2 So it makes it somewhat complicated.  
3 So first, you know, I wanted to have you  
4 address the statutory language, which it says  
5 we should use GAAP to the maximum extent  
6 practicable, and why here you see that it's  
7 not practicable?

8 MR. LESEUR: I think in response to  
9 your question, when the issue of acquisitions  
10 premiums first came up, probably in the old  
11 revenue adequacy cases, which is where it  
12 first appeared, the ICC took the standard that  
13 they would consider whether to include  
14 acquisition premiums, in that case in revenue  
15 adequacy rate base on a case by case basis.

16 I think if you look at the merger  
17 cases, that's what folks have done. You  
18 consider to include or not include a premium  
19 on a case by case basis.

20 And we've been trying, here, just to  
21 say that our case is different from the ones  
22 that have been approved in these other

1       mergers.

2               Insofar as the statutory language is  
3       concerned, it does say to the extent  
4       practicable. It doesn't require you to, and  
5       I don't think anybody in this case is arguing  
6       that you are precluded from excluding the  
7       premium in this case.

8               So I think our position would be  
9       that its not practicable to include it when it  
10      produces regulatory rate outcomes which are  
11      not fair to captive consumers.

12              CHAIRMAN ELLIOTT: I don't know if  
13      this question goes directly to you. But if we  
14      had to, I guess, pick the method, purchase  
15      accounting versus historic cost, that would be  
16      the most accurate of reflecting the value of  
17      BNSF.

18              Can you explain which one you would  
19      choose in this instance, without regard to how  
20      it would effect, I guess, the jurisdictional  
21      threshold and revenue adequacy?

22              MR. WILSON: I'll take a crack at

1       that.

2                   CHAIRMAN ELLIOTT:   Sure.

3                   MR. WILSON:   I don't think that the  
4       argument here is really one, at least not the  
5       argument I'm making, it's not really one that  
6       the value of BSNF is lower than what the price  
7       was that was paid.

8                   An argument that I would make, and I  
9       have in my statements, is that the inclusion  
10      of the premium for captive shippers would be  
11      grossly unfair because it would result in  
12      double compensation of that premium.

13                  It may be the case that the market  
14      value has inflated and is now \$8 billion more  
15      than it was historically.

16                  But captive rate payers have paid  
17      for that inflation. They have paid for that  
18      inflation in the rates of return that have  
19      been allowed. That's true here and it's also  
20      true in public utility economics.

21                  The rate of return that's allowed is  
22      a nominal rate of return that includes both

1 the real rate of return and the risk of  
2 inflation.

3 In unregulated markets for shippers  
4 that are not captive, for shippers whose rates  
5 are not subject to control, the returns that  
6 are earned include returns that are the real  
7 returns.

8 And investors are compensated for  
9 inflation through capital gains. So from a  
10 fairness, from a point of view of equity, from  
11 a point of view of regulatory principles, I  
12 would exclude the acquisition premium from  
13 regulated rates for captive shippers, not  
14 because of some argument that BNSF is not  
15 worth that much, but because it would result  
16 in double compensation from these captive  
17 consumers.

18 CHAIRMAN ELLIOTT: Okay, and back to  
19 the legal question. With respect to the  
20 precedent, you mention that all the other, or  
21 I assume all the other cases where we did end  
22 up marking up or marking down the assets, in

1       those instances, especially where we marked  
2       up, there were synergies.

3               I know BNSF cited the Blackstone  
4       case. And how would you rationalize that with  
5       the Blackstone case?

6               MR. CROWLEY: We looked at the  
7       Blackstone case and I think BNSF's initial  
8       position was that there were no synergies in  
9       the Blackstone case.

10              But I don't think that's the case,  
11       as we demonstrate in our testimony. There  
12       were synergies, and there were considerable  
13       synergies. And that fell right in line with  
14       how the STB and ICC have historically looked  
15       at mergers.

16              As long as there were synergies to  
17       offset the premium, it was an acceptable  
18       transaction.

19              CHAIRMAN ELLIOTT: And in reading  
20       the Blackstone case, I went back and read it,  
21       and they didn't mention much about whether or  
22       not they were going to write up things.

1           But I did review, I guess, the way  
2           they were going to go about creating savings.  
3           And that seemed to be, to me, to be unrelated  
4           to the actual transaction itself.

5           It seemed to be more of a business  
6           plan, as if Berkshire Hathaway had come in and  
7           said I'm going to get rid of a lot of the  
8           management and cut back on employees and do  
9           some other things that create things more as  
10          a consultant type action as opposed to  
11          something that was a result of the merger.

12          So do you see it that way? Or do  
13          you see those synergies as something that was  
14          created by the actual transaction itself?

15          MR. CROWLEY: I think the  
16          information that we saw was that it was very  
17          consistent with the other mergers in that we  
18          identified annual synergies of 100 million.

19          And 54 million of those were  
20          associated with the elimination of overhead  
21          costs and related benefits.

22          That is a typical synergy that you

1 would expect in a merger that would be used,  
2 at least the justification would be used to  
3 offset the premium pay.

4 So I think the synergies lined up  
5 pretty well when you look at what categories  
6 they were targeting.

7 CHAIRMAN ELLIOTT: Usually, when I  
8 think of it, you know, in the past mergers, I  
9 mean, you get rid of overhead by reducing  
10 duplication, like, clerks end up losing,  
11 you're usually adversely affected by  
12 transactions, some of the management  
13 activities are consolidated.

14 But in this instance, there doesn't  
15 seem to be anyone to really consolidate with.  
16 There was just one railroad. So it doesn't  
17 seem like you have the same kind of synergies.

18 MR. CROWLEY: Are you talking  
19 Blackstone now?

20 CHAIRMAN ELLIOTT: Blackstone,  
21 still. Yes, that there wasn't really a merger  
22 of two railroads where those were some kind of

1       duplication being eliminated.

2               It seemed more like they were just  
3       trying to reduce overhead because that seemed  
4       like the prudent thing to do, not because of  
5       the merger.

6               MR. CROWLEY: It was a result of the  
7       merger, or the acquisition by Blackstone.  
8       Maybe CNW wasn't doing their job right. But  
9       nonetheless, the acquisition created synergies  
10      that were passed through to the captive  
11      shippers, theoretically.

12              CHAIRMAN ELLIOTT: Okay, and my last  
13      line of questioning, just kind of going back  
14      to, you know, the legal. The way I read the  
15      statute and look at the precedent and prior  
16      positions, it seems like this is a difficult  
17      case for WCTL to make.

18              However, I do understand your  
19      concerns about the equitable ramifications of  
20      this situation here.

21              And if we addressed the situation in  
22      Western Fuels and Basin Electric, in that case

1       itself, and dealt with it, and hypothetically  
2       that worked out to your liking, at that point,  
3       would you feel more comfortable with allowing  
4       us to write up the assets at that point?

5               MR. LESEUR: Well, since we  
6       represent, in this case, that Basin Electric  
7       and AEPCO, we want to discourage the Board  
8       from taking any action that would address the  
9       premium.

10              But we're here today on behalf of a  
11       larger group of individuals. And, you know,  
12       our position is that this is the proceeding  
13       where the Board can take a look at the  
14       acquisition premiums that applies to BNSF.

15              I mean, it does directly impact at  
16       this point Western Fuels and AEPCO, but it  
17       also impacts everybody else that's either  
18       coming before this Board without a  
19       negotiations.

20              And we believe that the proper way  
21       to approach it is to remove the premium from  
22       the BNSF's URCS for all purposes and for all

1 cases, not just for these two shippers.

2 And, you know, insofar as past  
3 precedent is concerned, we believe this is  
4 probably the first case where we really have  
5 a major focus by the shipping community, you  
6 know, on the premium.

7 There was some discussion of it in  
8 Con Rail, but this is the first time, because  
9 of the nature of this transaction, where there  
10 are no offsetting synergies where you take  
11 direct hits.

12 And that's why the Western Coal  
13 Traffic League, the other organizations and  
14 all the other shippers here, you know, are  
15 participating. And our belief is the proper  
16 approach is to view these acquisition premiums  
17 on a case by case basis.

18 We're not asking the Board to change  
19 its accounting rules. We're just saying for  
20 purposes of the Board staff developing its  
21 URCS for BNSF and the Board staff developing  
22 the net investment base for revenue adequacy

1       purposes, that the premium be removed.

2               And one other thing, if you punt  
3       this back down to individual cases, then we're  
4       going to have to basically put the same  
5       firepower into the individual cases. These  
6       cases cost money.

7               And so I can't imagine we're going  
8       to make any, you know, different arguments  
9       then we've already made in this case back in  
10      the individual dockets.

11              CHAIRMAN ELLIOTT: Just my last  
12      thought about all of this. So this is the  
13      full hypothetical here.

14              We take care of whatever's going on  
15      in Western Fuels, and we follow precedent.  
16      And what if we decided to take an equitable  
17      type view of this, with an equitable remedy  
18      and we engaged in some type of phasing in of  
19      the premium?

20              Would that be satisfactory to you as  
21      opposed to going against the precedent that  
22      we've had in the past?

1                   MR. CROWLEY: It seems to me that  
2 would be going against the precedent. If  
3 you're going to change the precedent, do  
4 what's fair, balance it off.

5                   Do what the STB and the ICC has done  
6 before, and that is, if you don't see the  
7 synergies, you don't get the premium.

8                   CHAIRMAN ELLIOTT: Okay, let's say  
9 hypothetically I buy the Blackstone case, that  
10 there weren't any synergies there. And so I  
11 don't go with that argument.

12                   In that instance, would you think  
13 that phasing in would be a way of going about  
14 this to, I guess, kind of level the playing  
15 field?

16                   I mean, it would be an equitable way  
17 to deal with this as opposed to changing the  
18 way we've done things for a long time.

19                   MR. CROWLEY: Well, I don't see that  
20 as equitable. You know, you're still giving  
21 the benefit to the railroad, although a little  
22 bit slower, without any benefits to the

1 shipper.

2 So whether it takes an instant hit  
3 on your rates or whether it takes a gradual  
4 hit on your rates, you're still getting the  
5 higher rates because of the acquisition of  
6 this railroad.

7 CHAIRMAN ELLIOTT: Okay. And my  
8 last question is, it just does reflect on, and  
9 I'll ask both sides this question, or I'm sure  
10 some of the other Board members will.

11 You know, with respect to the change  
12 in positions over time, the shippers, at one  
13 point in time, were in favor of purchase  
14 accounting and the railroads weren't.

15 And now the sides seem to have  
16 changed their positions. Has anything changed  
17 since the sides changed their positions over  
18 these matters that would suggest that we  
19 should change the way we are doing things?

20 MR. CROWLEY: I don't think so.

21 CHAIRMAN ELLIOTT: Okay.

22 MR. LESEUR: I'm not sure how many

1 shippers have actually changed sides. I  
2 believe that there was a subset of the shipper  
3 community back at one time that took one  
4 position that may be different then it is  
5 right now.

6 And things were different back, you  
7 know, 1987. One of the things, like, you  
8 talk, the accounting principals board report  
9 has come up. And at that time, the ICC wasn't  
10 using variable costs to set rates.

11 And so, you know, things are  
12 different now. You have a substantially  
13 different mechanism for setting rates. Even  
14 in the stand alone cases, now, we're using  
15 variable costs and your MMM methodology where  
16 you lock in, even the SAC rate is locked in  
17 based upon what a variable cost is.

18 And your three benchmark, you know,  
19 you're using ratios over a base variable cost.  
20 So we have, you know, a different situation  
21 going on right now.

22 And one of the folks that actually

1 recognized that way back in 1987 was Dick  
2 Briggs, who was the executive director of the  
3 AAR.

4 And one of his arguments was, you  
5 know, right now the market value of railroads  
6 is below the book value, but things could  
7 change. And if it does change, it'll be to  
8 the detriment of captive shippers.

9 So they were, in fact, making  
10 basically the same argument that we're making  
11 here today. And, while some shippers opposed  
12 what Mr. Briggs was saying, not all of them  
13 did.

14 CHAIRMAN ELLIOTT: Okay, so just so  
15 I follow that. There were certain shippers  
16 that were in favor of purchase accounting in  
17 that point in time.

18 My understanding is because they  
19 were marking it down at that point in time.  
20 And were there, in fact, shippers that were  
21 taking the opposite position? Or were they  
22 remaining neutral?

1           MR. LESEUR: My recollection is that  
2           there were some shippers that were probably  
3           taking no position.

4           CHAIRMAN ELLIOTT: Okay.

5           MR. LESEUR: Yes.

6           CHAIRMAN ELLIOTT: Vice Chairman?

7           VICE CHAIRMAN MULVEY: Thank you. I  
8           have a couple of questions.

9           Some observations for Mr. Crowley on  
10          the slides you submitted. You have the change  
11          in the jurisdictional threshold expressed in  
12          terms of cents per ton or dollars per ton.

13          You know, you have to do the  
14          calculations. How many tons am I going to be  
15          moving and how many cars are there, et cetera,  
16          et cetera?

17          I guess it would be interesting if  
18          you have, and maybe you don't have this off  
19          the top of your head, what percentage increase  
20          this would be in the jurisdictional threshold  
21          for these commodities?

22          You had a 1,200 mile grain shipment

1 increasing 40 cents per ton, and a 1,000 mile  
2 coal shipment increasing 58 cents a ton. What  
3 percentage increases would these be?

4 You do have to dig it out right now,  
5 but the same is also true of the losses to WFA  
6 Basin's transportation charges, the increases  
7 in their cost as well as AEPCO's cost.

8 It's not clear how big those  
9 increases are, given the overall size of the  
10 awards for those cases.

11 MR. CROWLEY: Well, to answer your  
12 question directly, it's your two to three  
13 percent, in that neighborhood.

14 VICE CHAIRMAN MULVEY: Okay.

15 MR. CROWLEY: But I think if you  
16 look at a percentage, it sounds so small.  
17 You take a very small percentage and you  
18 multiply it by a lot of tons, which Western  
19 Fuels ships, if you're doing eight or nine  
20 million tons a year, and you've got 60 cents  
21 a ton, you're talking about some serious cash.

22 VICE CHAIRMAN MULVEY: It can become

1 a big number when multiplied by a big enough  
2 number.

3 The court, however, in the Conrail  
4 acquisition case agreed with the STB that a  
5 rise in variable costs of, I think it was 7.26  
6 percent in NS's case and 4.9 percent for CSX,  
7 was small enough not to be a problem.

8 Now, I believe WCTL's estimate is  
9 that BNSF's variable costs will only increase  
10 about four percent.

11 So if there's only going to be four  
12 percent on your particular case here, these  
13 examples may even be less than four percent,  
14 why should we treat this case any differently  
15 from how we treated Conrail? Or how the court  
16 agreed that we should treat Conrail?

17 MR. CROWLEY: Well, I think it goes  
18 back to the synergies. You know, eventually,  
19 in the Conrail case, and I'm thinking back to  
20 your logic, the STB's logic as to why they  
21 approved that, it was a lot of argument about  
22 the premium.

1           And as long as the synergies were  
2           there, the board decided that it was  
3           acceptable to let this thing go forward. So  
4           I think the small percentages didn't weigh  
5           into that decision at all.

6           VICE CHAIRMAN MULVEY: Well, we do  
7           hear from a number of people who have  
8           expressed concerns about the fairness issue,  
9           and that it's unfair that these acquisition  
10          costs can be passed on to shippers, especially  
11          to captive shippers, who may already be paying  
12          higher rates.

13          But let me follow up on the variable  
14          cost issue. Even though you're arguing that  
15          synergies are the issue here, what if the  
16          impact on variable costs were larger than what  
17          BNSF and WCTL estimated?

18          What if they were more like ARC's  
19          estimate of, I believe that was around 9.6  
20          percent?

21          Would you think then, that would  
22          become an important part of the argument, if

1 indeed, the cost, in fact, were greater than  
2 the two or three or four percent that's been  
3 estimated by WTCL and others?

4 MR. CROWLEY: I think, again, we go  
5 back to what does two or three percent  
6 translate into in monies? And go to the  
7 Western Fuels example.

8 What you're suggesting is, instead  
9 of Western Fuels having to pay an additional  
10 \$25 million for it to reach a level that  
11 you'll look at it, they've got to pay \$50  
12 million more or \$75 million more.

13 \$25 million is a lot of money to me.  
14 I'm not sure how you guys look at it.

15 VICE CHAIRMAN MULVEY: Well, we're  
16 government workers, so it's a lot of money to  
17 us, also. And on the other hand, of course,  
18 is it a lot of money to Apple?

19 It does depend, also, on the size of  
20 the organization, it's revenues and it's  
21 overall standing.

22 So I don't want to, you know, quote

1       Senator Dirksen again, but you know, a million  
2       dollars or a billion dollars here, a billion  
3       dollars there, pretty soon you're talking  
4       about real money.

5               To follow up on the mergers issue,  
6       though, how big of a role did the synergy  
7       argument play in prior transactions?

8               Reviewing the prior cases, it  
9       doesn't seem that the decision really turned  
10      on them. They were mentioned, but it doesn't  
11      seem that the decision really turned on the  
12      existence of synergies in the mergers in terms  
13      of allowing the acquisition premiums.

14              MR. CROWLEY: We participated in  
15      each one of those mergers on behalf of  
16      different groups of shippers.

17              And there was an awful lot of  
18      rhetoric about synergies, and how real they  
19      were, and how they would be quantified.

20              And ultimately, the argument came  
21      down to, if you're going to have a premium,  
22      you've got to have synergies.

1                   And how real are the synergies,  
2                   because everybody was of the belief the  
3                   premium was going to be accepted. So we got  
4                   to be sure we do have synergies to offset  
5                   these premiums.

6                   VICE CHAIRMAN MULVEY: And you feel  
7                   that the prior decisions did turn on the  
8                   synergy argument?

9                   MR. CROWLEY: Yes.

10                  VICE CHAIRMAN MULVEY: Okay.

11                  MR. WILSON: May I take a moment to  
12                  interject one other thought on synergies  
13                  that's a little bit different than what's been  
14                  talked about so far, which I think is  
15                  important?

16                  If there are synergies in a merger,  
17                  if there are improvements in service, if there  
18                  are reductions in costs, the merged firm has  
19                  the ability to go into competitive markets and  
20                  reflect that in the prices that it charges,  
21                  because it's offering a better product or it's  
22                  able to make a better margin because it's been

1       able to reduce it's costs.

2               It's going to be able to recover  
3 premiums because of the synergies that have  
4 been created in competitive markets.

5               And of course, in those situations,  
6 your job is to protect the captive shippers.  
7 So reflecting synergies in captive shippers  
8 rates is not going to be terribly different  
9 than what is reflected in the competitive  
10 market.

11              Here, if there are no synergies, no  
12 quality improvements, no cost reductions,  
13 there really isn't that opportunity in a  
14 competitive market to raise rates.

15              Here, the request to include the  
16 premium in only captive shippers rates is  
17 really a serious type of discrimination  
18 against captive shippers and treating them  
19 different than competitive market shippers,  
20 and certainly not what the regulatory process  
21 was set out to do, which was to replicate the  
22 effects of a competitive market where

1 competition is absent.

2 VICE CHAIRMAN MULVEY: Someone  
3 argued the difference between railroads and  
4 utilities is that virtually all utility rates  
5 are regulated, whereas most railroad rates  
6 are, in fact, unregulated.

7 And that only a small fraction of  
8 total railroad rates are, in fact, regulated  
9 by this board.

10 MR. WILSON: Actually, today, a very  
11 large portion of the electric utility rates  
12 regulated by FERC are subject to market rate  
13 authority. And so most of your big electric  
14 generators these days have a very substantial  
15 portion of their generation being sold at  
16 market prices.

17 And there really isn't any problem  
18 in distinguishing between the captive market  
19 and the competitive market and implementing  
20 that to the regulatory restrictions that are  
21 necessary. Only with regard to the captive  
22 market.

1           VICE CHAIRMAN MULVEY: Assuming, for  
2           a moment, and I don't want to pre-judge our  
3           decision, but assuming for a moment that we  
4           permitted BNSF to write up these assets in the  
5           fashion that they desire, should we reconsider  
6           our position and permit all Class I carriers  
7           to make a similar adjustment, just in the name  
8           of equity?

9           MR. WILSON: Wow.

10          VICE CHAIRMAN MULVEY: What's good  
11          for the goose is good for the gander.

12          MR. WILSON: That would --

13          VICE CHAIRMAN MULVEY: Or what's bad  
14          for the goose is bad for the gander.

15          MR. WILSON: That doesn't sound like  
16          good consumer protection to me, speaking from  
17          a regulatory perspective.

18          VICE CHAIRMAN MULVEY: Well,  
19          something that you had mentioned about writing  
20          up railroad assets to reflect replacement  
21          costs, which has been charged here.

22          If we do that, shouldn't we lower

1 the return on investment and actually use the  
2 real cost of capital, which excludes  
3 inflation, as opposed to the nominal costs of  
4 capital?

5 I think you made that argument that  
6 we should be doing that if we, indeed, went  
7 ahead and accepted the acquisition premium.

8 MR. WILSON: Yes. You should, but  
9 historically, that has not been the case. And  
10 of course, captive shippers have paid for the  
11 inflation that's taken place up until now.

12 So you have a transitional problem.  
13 And my recommendation would be to disallow for  
14 captive rates, this particular premium, but to  
15 go forward on a rate of return basis to  
16 reflect that only the real cost of capital and  
17 not the inflation adder.

18 VICE CHAIRMAN MULVEY: Thank you.

19 COMMISSIONER BEGEMAN: Could you  
20 comment on how Burlington Northern's rates  
21 have changed since the February 2010 purchase?

22 MR. WILSON: I don't know the answer

1 to that question.

2 COMMISSIONER BEGEMAN: Or how other  
3 railroad's rates may have changed over that  
4 period as well?

5 MR. LESEUR: I think it's virtually  
6 impossible to answer your question because  
7 most rate negotiations are confidential. And  
8 you can't just discuss what's going on in a  
9 contract, you know, discussion.

10 And I'm not sure that BN has  
11 released anything publicly. If you look at  
12 rates that you --

13 COMMISSIONER BEGEMAN: Well, I meant  
14 the rate of the shippers that you represent.

15 MR. LESEUR: If you look at rates  
16 that you can see, if you look at, say for  
17 example, the Basin Electric rates under their  
18 prescription, you'll see that they've been  
19 generally trending upward, virtually every  
20 quarter that the rate prescription, most of  
21 the quarters the rate prescription has been in  
22 effect.

1                   COMMISSIONER BEGEMAN:   Mr. Wilson,  
2                   in response to, I believe it was the  
3                   Chairman's question, he asked about if you  
4                   disagreed with BN's value.

5                   And you said you didn't, I believe.  
6                   I'm not putting words in your mouth. Is that  
7                   correct?

8                   MR. WILSON:   Yes.

9                   COMMISSIONER BEGEMAN:   So do our  
10                  policies and procedures undervalue the rest of  
11                  the railroads, as well?

12                  MR. WILSON:   I think under original  
13                  cost rate making, it is true that if you're in  
14                  an inflationary environment, and inflation is  
15                  moving at a greater rate than productivity, it  
16                  is likely that replacement cost depreciated  
17                  will exceed original cost depreciated.

18                  So that is a fact.   However, as I  
19                  mentioned earlier, I want to emphasize rate  
20                  payers have paid for that inflation.

21                  They've paid for that increase in  
22                  value because inflation is built into the rate

1 of return that the utility or that the  
2 railroad has earned from rate regulated  
3 customers.

4 To now turn around and say well,  
5 we're going to let you recover the premium,  
6 the inflation also, by putting the acquisition  
7 premium into rates would require these captive  
8 shippers, captive customers to pay twice for  
9 inflation.

10 So it is true that in an environment  
11 where you've got inflation that exceeds  
12 productivity, asset values do tend to increase  
13 over time. But rate payers have paid for  
14 that.

15 COMMISSIONER BEGEMAN: My question,  
16 and maybe you have the same response, is  
17 really not so much about Burlington Northern  
18 and the premium but the value of the other  
19 carriers.

20 MR. WILSON: That would apply to the  
21 other carriers, too. To the extent that their  
22 rates are regulated, and to the extent that

1       those regulated rates reflect a nominal cost  
2       of capital return, which as I understand, they  
3       do.

4               Rate payers have paid for that  
5       increase in value that may exist in their  
6       asset base.

7               MR. CROWLEY:   And your maximum rate  
8       standard is based on a reproduction cost new  
9       investment base.

10              I mean, so we're talking about  
11       investment that is higher than any of the  
12       investment bases we're talking about here in  
13       calculating maximum rates.

14              COMMISSIONER BEGEMAN:   Can any of  
15       you comment on Burlington Northern's actual  
16       calculation of the premium itself?   Do you  
17       disagree with the value they came up with?

18              MR. CROWLEY:   No.

19              MR. LESEUR:   I would say, in answer  
20       to that, that in this case, we didn't  
21       challenge it.   We did ask Burlington for it's  
22       work papers in how it calculated, basically,

1 the increase in the value in the property  
2 accounts.

3 And basically we were told that that  
4 wasn't an issue in this case. We're under an  
5 accelerated schedule. We all have budgets,  
6 and so we let that issue drop.

7 And so for purposes of this case,  
8 we're accepting, you know, how BNSF did it's  
9 accounting. And we worked with the accounting  
10 inputs that we had.

11 And Mr. Crowley developed the \$8.1  
12 billion impact on the property accounts, which  
13 was, I believe, is in the same general  
14 ballpark as what BNSF's experts came up with.

15 We didn't actually get into the  
16 details of whether the property was valued  
17 correctly or not because we just didn't have  
18 the data to do it.

19 COMMISSIONER BEGEMAN: In response,  
20 again I think it was to the Chairman's  
21 question, when he was talking hypothetically  
22 as if the Board would go forward and allow the

1 premium to remain in the asset base, he  
2 brought up the two rate prescription cases,  
3 both Western Fuels and AEPCO, that could be  
4 impacted here.

5 And I think you talked about the  
6 fact that we base the prescription using a  
7 variable cost ratio.

8 Have you given any thought as to  
9 whether the Board should use a different  
10 approach, not just for those two cases, but  
11 generally?

12 MR. LESEUR: I would answer that by,  
13 you know, just saying that I don't think we've  
14 given much thought to that issue in this  
15 proceeding.

16 And, you know, historically, I mean,  
17 I'm fairly old now, it took us ten years  
18 between 1977 basically and 1987 to come up  
19 with a stand alone test.

20 And we've been using it ever since.  
21 The Basin case, you know, has taken eight or  
22 nine years to litigate as that standard was

1 massaged.

2 And, you know, to go back and for a  
3 lot of folks to try to do that all over again  
4 --

5 COMMISSIONER BEGEMAN: So we can  
6 blame you for that standard?

7 MR. LESEUR: Blame Mr. Crowley. It  
8 would be something that we would have to, you  
9 know, think long and hard about the cost.

10 I mean, the cost of developing SAC  
11 and the cost of, you know, going through all  
12 these cases has been absolutely enormous for  
13 the shipping community. And you know, it's a  
14 very complicated system now to provide some  
15 relief for some shippers.

16 And in terms of, you know, doing it  
17 all over again, I think we would have to give  
18 that some serious thought in terms of how much  
19 it would cost to do it, what people would have  
20 in mind and what the answers would be.

21 COMMISSIONER BEGEMAN: And then what  
22 will be my last question to you, again in the

1       hypothetical. How would you propose, or could  
2       you propose, how the board should address  
3       AEPCO's rate prescription if the Board wanted  
4       to basically hold it harmless?

5               You know, in the record, even the  
6       carrier recognizes for Western Fuels that that  
7       may need to be addressed. That it's "unique,"  
8       I think is what they said, since the  
9       prescription went into effect before the  
10      purchase.

11             Given that it's a 180 threshold by  
12      law, how could AEPCO's rate prescription be  
13      held harmless? I don't know if I'm being very  
14      clear.

15             MR. LESEUR: Well, you know, like  
16      most things in life, you have to give that one  
17      some thought. We're asking to remove the  
18      premium from the URCS. You could just do what  
19      we're asking here and apply it in Western  
20      Fuels and in AEPCO.

21             I mean, you know, as I understand  
22      it, how you pull the premium out of the URCS

1 is a mechanical exercise. If you've seen some  
2 of Mr. Crowley's exhibits, you'll see there's  
3 a lot of steps that are involved.

4 I'm sure if you put it into a  
5 computer program, it can be done fairly  
6 simply. So the relief that we're asking for  
7 here could be applied in individual cases.

8 I think, you know, just doing what  
9 we're addressing here, which is addressing the  
10 premium, that would be one way of doing it.

11 COMMISSIONER BEGEMAN: No, and  
12 you've been very clear that your purpose here  
13 is to represent a number of shippers, not just  
14 your clients.

15 MR. LESEUR: Right. And the one  
16 thing about, you know, AEPCO and Western Fuels  
17 is, I mean, AEPCO is a JT prescription. You  
18 can see that's going to be the same in all the  
19 cases.

20 And you get a SAC case and you get  
21 into how the MMM model works and things like  
22 that. But you can see in this one case the

1       dollar impact of the two that are out there  
2       right now.

3               And you can see the impact on JT and  
4       everyone. And one thing to think about is the  
5       impact of this in these small rate cases  
6       because, Mr. Crowley put a couple of examples  
7       in.

8               I think we had to designate them as  
9       highly confidential using the data that we  
10      were using. But you can take, you know,  
11      between 50 to 70 percent of the relief away.

12              And you're not going to have  
13      somebody in a small rate case being able to  
14      come in here and argue about adjusting the URCS  
15      because the cost of the adjustment may be more  
16      than the cost of the relief or the amount of  
17      relief you can get with a million dollar cap.

18              VICE CHAIRMAN MULVEY: One of the  
19      things that the petitioners argued is that by  
20      allowing the acquisition premium to go forward  
21      as BNSF would like, it would push the BNSF  
22      further away from revenue adequacy.

1           Even though BNSF was not revenue  
2       adequate before, it would be even less so.  
3       And as you said, once the full premium goes  
4       in, it would be even less so.

5           But historically, virtually none of  
6       the railroads have been found to be revenue  
7       adequate. I believe in our last calculation,  
8       only a single railroad was declared revenue  
9       adequate.

10          The Board has taken a lot of heat on  
11       the measure of this over time, and it's so  
12       difficult to explain to the Congress and to  
13       others the difference between profitability,  
14       which the railroads have tended to be and  
15       revenue adequacy, which the railroads,  
16       according to the STB's calculations of revenue  
17       adequacy, have tended not to be.

18          Is this a problem that perhaps the  
19       Board ought to rethink how it calculates  
20       revenue adequacy in deciding whether or not to  
21       regulate as opposed to how it does it today?

22          MR. CROWLEY: Let me just offer a

1 quick summary of an analysis we did. One of  
2 the fallouts of this acquisition by Berkshire  
3 is that BNSF is no longer part of the cohort  
4 that is used to calculate the annual cost of  
5 capital.

6 And what has not been tested by the  
7 STB is what's the impact on the cost of  
8 capital of doing, of including BNSF into the  
9 2010 calculation, for example.

10 Based on our calculations using some  
11 numbers that we submitted to the Board and the  
12 Board didn't like, we found that when you put  
13 BNSF back into the 2010 cost of capital, all  
14 four major Class I railroads did pass the  
15 revenue adequacy test.

16 Having said that, I'm not an  
17 advocate of the revenue adequacy test. I  
18 don't think it is any indication of what the  
19 health is, financially or economically of  
20 these rail carriers. I think you ought to do  
21 away with it.

22 VICE CHAIRMAN MULVEY: Thank you.

1                   CHAIRMAN ELLIOTT: I had one last  
2 follow up question. And this kind of follows  
3 what the Commissioner was asking.

4                   I understand that there would be  
5 some effects, some obvious effects on the  
6 cases that have already been heard.

7                   My understanding with respect to the  
8 SAC cases themselves going forward that other  
9 than the jurisdictional threshold, there  
10 really wouldn't be an effect as a result of  
11 the write up because you're using replacement  
12 costs of the SAC in that instance as opposed  
13 to the way we're evaluating or valuing the  
14 items here. So can you respond to that?

15                  MR. CROWLEY: I think you're still  
16 applying the results of SAC to those MMM  
17 ratios that you developed to variable cost  
18 every year.

19                  Every year, you're going to  
20 calculate the variable cost and apply the MMM  
21 ratio. If your variable costs go up, and your  
22 MMM ratio, assume it stays the same, which it

1       wont, but assume it does, you're still getting  
2       a higher prescribed rate then you were before  
3       the premium was included.

4               CHAIRMAN ELLIOTT: But would that  
5       happen to everyone across the Board?

6               MR. CROWLEY: It would impact all  
7       BNSF captive shippers.

8               CHAIRMAN ELLIOTT: Right, in the  
9       same manner, so I don't know, would it effect  
10      the actual SAC outcome, though? I don't see  
11      how it would.

12              MR. LESEUR: Well, the SAC outcome,  
13      you know, in the end, which you end up with  
14      under SAC and you go through the 5 million  
15      steps as you get a RVC ratio cap.

16              And it's based on, you know,  
17      variable costs and variable cost, if you had  
18      a BN prescription, it's based on BN's variable  
19      costs for a particular year multiplied by your  
20      MMM ratio.

21              And if you include the premium in  
22      the URCS, the variable costs are going to go

1 up. Mr. Crowley just says if you multiply it  
2 by the same MMM ratio, your rates are going to  
3 go up.

4 I mean, you can just look at what's  
5 going on in the Western Fuels case right now.  
6 The premium was included, as I recall, in the  
7 first quarter adjustment, and it pushed the  
8 rates up.

9 And it's going to be the same for  
10 anybody in a future case that has a  
11 prescription. Now BN's made some arguments,  
12 well if you get into the details of the MMM  
13 model, you know, something could offset that.

14 But, you know, that's based on some  
15 assumptions they made. Mr. Crowley puts us in  
16 some different hypotheticals in the record  
17 that would show that, you know, the impacts in  
18 terms of the MMM model itself, you can still  
19 get some fairly significant increases.

20 I think everybody agrees, if you put  
21 the premium into the URCS, the base variable  
22 cost numbers you're multiplying the MMM ratio

1       against is going to increase.

2               And BN's argument, as I understand  
3       it, was that will be offset by changes in the  
4       way the MMM model works where you also have  
5       variable costs being used to allocate SAC  
6       revenues per your traffic group.

7               Then you get into some issues about  
8       the assumptions, they make counter  
9       assumptions. But, you know, so clearly it's  
10      not just an issue under SAC right now in terms  
11      of how this premium impacts.

12              In the old days, before you went to  
13      MMM, unless you had a JT prescription, in  
14      terms of the SAC, it probably wouldn't have  
15      made that much of a difference.

16              But because you've gone to RVC ratio  
17      calculation, it does. And we would also point  
18      out that, you know, five of the last ten SAC  
19      cases, the national rate was set at the JT.  
20      So, you know, that's what's actually happened.

21              And so when you talk about a SAC  
22      case, you know, the standard is, is the

1 maximum rate the greater of SAC or the JT.

2 And half of your cases since 1996, the large  
3 ones, JT has set the rate. And this,  
4 obviously, impacts the JT.

5 CHAIRMAN ELLIOTT: Yes, I can see  
6 how it affects if you're setting at 180.

7 MR. LESEUR: Right.

8 CHAIRMAN ELLIOTT: I don't see it as  
9 much in the other parts of it. I understand  
10 in the methodology and the allocation, though.  
11 It would seem that it would level out across  
12 the board, because everyone across the board  
13 would change their RVC ratios as a result of  
14 the premiums.

15 MR. CROWLEY: They won't change  
16 uniformly. I mean, implicit in your statement  
17 is that everybody in the MMM cohort changes  
18 uniformly. They don't.

19 Variable costs change based on  
20 distance and weight. And to the extent, your  
21 mix of traffic reflects all of the different  
22 commodities and transportation conditions.

1                   That's going to change. And it  
2                   won't be a uniform change. And we made that  
3                   demonstration.

4                   CHAIRMAN ELLIOTT: And is there any  
5                   way to show who it would affect more in that  
6                   instance?

7                   MR. CROWLEY: Sure, sure. I mean,  
8                   it's very quantitative. I can't sit here and  
9                   tell you who --

10                  CHAIRMAN ELLIOTT: I mean, would it  
11                  necessarily affect the person who brings the  
12                  case more?

13                  MR. CROWLEY: Depends on the mix of  
14                  traffic that's included in the stand alone  
15                  group.

16                  CHAIRMAN ELLIOTT: Sure, okay, thank  
17                  you. I have nothing further. Why don't we  
18                  call up the next panel. Thank you very much.  
19                  I guess we'll see you again shortly.

20                  MR. MCBRIDE: Mr. Chairman, I wonder  
21                  if we could realign our panel? We have an  
22                  agreed upon order. Is that acceptable with

1 the Board?

2 CHAIRMAN ELLIOTT: It's quite fine.

3 MR. MCBRIDE: I think my other panel  
4 members will agree, we've agreed that Mr.  
5 Hurst would go first, Mr. Whiteside second,  
6 Mr. Cutler third, and I'm batting cleanup.

7 CHAIRMAN ELLIOTT: Great, now we'll  
8 hear from the third panel of shipper  
9 interests. And I believe we'll start out with  
10 Mr. Hurst.

11 MR. HURST: Thank you, Chairman  
12 Elliott and Vice Chairman Mulvey and Board  
13 Member Begeman. It's a pleasure to be here.

14 My name is Wayne Hurst. I'm a  
15 wheat, sugar beet, barley and dry bean grower  
16 from the Burley, Idaho area. I am the  
17 immediate past president of the National  
18 Association of Wheat growers, and a past  
19 president of the Idaho Grain Producers  
20 Association.

21 I am also involved with the Alliance  
22 for Rail Competition, the BNSF Ag-Rail

1 Business Council, and I have worked on  
2 transportation issues for a number of years as  
3 they relate to agriculture.

4 I appreciate the opportunity that  
5 you have provided us to come before you today.  
6 I want to thank you, first of all, for your  
7 efforts and acknowledge the work that your  
8 agency does in the rail customer and public  
9 assistance program.

10 And we encourage you to continue to  
11 consider carefully the legitimate needs and  
12 concerns of the captive shipper.

13 I am here to voice our concern that  
14 the acquisition premium paid by Berkshire  
15 Hathaway when the Burlington Northern Santa Fe  
16 Railroad was purchased, if allowed by this  
17 board to be included in the BNSF rate base,  
18 will be paid in large part by captive  
19 shippers, including agriculture.

20 We are also concerned that in the  
21 future, more premiums are quite possible that  
22 it could affect other railroads, ultimately

1       effecting competition and rail rates of all  
2       agricultural shippers.

3               I'm a full time family farmer. In  
4       the spring we till the soil as needed with  
5       fertilizer and plant our crops. We carefully  
6       nurse and watch over them. We provide water  
7       as needed and control pests.

8               Throughout the year, we use every  
9       tool that we can to maximize production,  
10      minimize our risk, and take advantage of the  
11      highs of the market.

12              I, my family, and our hired workers  
13      work long and hard. In most cases, our farms  
14      have been passed down from previous  
15      generations, and we hope to pass them down to  
16      future generations.

17              For most of us, farming is not just  
18      a career, it's a legacy and a trust. We take  
19      a long term view of life. We have a  
20      tremendous amount of capital invested in land,  
21      equipment, and growing crops.

22              This investment reflects the

1 sacrifice and hard work of not just ourselves,  
2 but often of previous generations. One or two  
3 bad years can literally bring that heritage of  
4 our family farm to an end.

5 So we are very conscious of profit  
6 margins, expenses, risk and productivity. In  
7 order to produce wealth, we must ship our  
8 crops to market.

9 For many wheat producers, rail is  
10 the only realistic option, because of  
11 consolidation in previous decades, most of us  
12 are served by one major railroad.

13 We need them. We rely on them, and  
14 view them as partners. We want the railroads  
15 to be profitable, efficient, and reliable. We  
16 are also willing to pay a fair price for their  
17 services.

18 Wheat growers know that an effective  
19 railroad system is necessary for the success  
20 of the wheat industry. However, we continue  
21 to face problems with rail rates, and at times  
22 with service.

1           In October 2007, the Government  
2           Accountability Office issued a report  
3           confirming what we in the captive shipper  
4           community have been stating for years.

5           Those areas that are captive pay the  
6           highest freight rates, yet often receive some  
7           of the worst service. For most of us, rates  
8           remain high.

9           Farmers experience it and suspect  
10          it, and both government studies and word by  
11          independent consultants confirm it. The  
12          Christensen Study further confirmed the  
13          highest freight rates in captive areas.

14          And this study was followed by an  
15          extensive study by the USDA showing that the  
16          GAO correctly established a link between  
17          single railroad access and an elevated  
18          percentage of tonnage above the threshold for  
19          rate relief.

20          Our own studies and research  
21          confirms the findings of the GAO study, the  
22          Christensen Study and the USDA study.

1           The acquisition premium paid by  
2           Berkshire Hathaway, if allowed by this board  
3           to be included NSF rate, will be made up on  
4           the backs of captive shippers. And that will  
5           affect all of us in agriculture and in rural  
6           America.

7           This is a rural America issue. And  
8           what is at stake is our ability to be  
9           competitive, both in U.S. and in the world  
10          markets.

11          We did not ask to be captive to the  
12          railroad system. But as we are now captive,  
13          we need the board to look at this issue from  
14          an agricultural perspective.

15          From a simplistic view, investments  
16          that are included in cost bases should be  
17          costs that increase efficiencies or benefits  
18          to existing shippers.

19          The acquisition premium did not, by  
20          itself, create increased efficiencies or  
21          benefits to existing shippers and consumers.

22          When we experienced low prices

1       because of higher costs, such as  
2       transportation, it effects our ability to  
3       purchase equipment, fertilizer, seed, and meet  
4       our other expenses.

5               We have a real concern how this case  
6       will affect the future capital investment of  
7       other railroads by future wealthy investors.

8               If the BNSF's new owners can buy a  
9       railroad at higher than market prices and  
10      subsequently pass off the additional cost to  
11      the captive shippers, captive shippers will be  
12      harmed.

13              I think I'm out of time, so I thank  
14      you again for being here today, and encourage  
15      you to look at this carefully.

16              CHAIRMAN ELLIOTT:  Thank you, Mr.  
17      Hurst.

18              MR. WHITESIDE:  This mic on?  There  
19      we go.  Okay, we're going to have ten minutes  
20      between the two of us, and so I'll just finish  
21      up and then he can carry on.

22              Chairman Elliott and Vice Chair

1 Mulvey, Commissioner Begemen, my name is Terry  
2 Whiteside. I appreciate the opportunity to  
3 speak to you today on behalf of the Alliance  
4 for Rail Competition, of which I am the  
5 chairman.

6 I represent the Montana Wheat and  
7 Barley Commission and committee on that board.  
8 I'm also speaking for ten wheat and barley  
9 commissions representing producers from Texas  
10 to the Pacific Northwest for whom I am a  
11 consultant and an adviser.

12 ARC members also include coal  
13 shippers. You've just heard an excellent  
14 presentation by Western Coal Traffic League.  
15 ARC supports WCTL in what they've told you  
16 about the adverse impacts about the \$8 billion  
17 write up.

18 A lot of what I'm going to talk  
19 about is somewhat similar to what they were  
20 talking about, so I will try to brief it a  
21 little bit.

22 But contrary to the BN's arguments,

1 the adverse impacts are not limited to just  
2 coal shippers. For example, Western Fuels is  
3 a member of WTCL and also a member of ARC.

4 But ARC members also ship things  
5 like frac sand, glass, manufacturing, many  
6 agriculture commodities, peas and lentils.  
7 And they're all adversely affected by higher  
8 and increasing BN rates for a range of other  
9 commodities needed to operate farms.

10 I've got a chair problem. Why is my  
11 chair going down? Sorry. As for the wheat  
12 and barley committees, their members received  
13 --

14 CHAIRMAN ELLIOTT: It's a common  
15 problem.

16 MR. WHITESIDE: Pardon me?

17 CHAIRMAN ELLIOTT: It's a common  
18 problem.

19 MR. WHITESIDE: Did I get the  
20 special chair today? Is that --

21 VICE CHAIRMAN MULVEY: There's that  
22 little thing on the side. You pull that up

1 and then you sit up and then it will go up  
2 again. But you have to sit up when you do it.

3 CHAIRMAN ELLIOTT: You have to sit  
4 up.

5 MR. WHITESIDE: I don't want to get  
6 shorted time. BN rates have steadily risen  
7 over the years going up when the markets are  
8 favorable to grain producing shippers.

9 However, when the grain markets fall  
10 back from their peaks, the rail rates don't  
11 fall. They continue to increase. If the  
12 board rules in the BNSF's favor in this  
13 proceeding, more rate increases are sure to  
14 follow.

15 Captive shippers' abilities to  
16 resist excessive rates will be weakened. All  
17 captive shippers by railroads are vulnerable  
18 to high rates, rate increases, service  
19 problems, including being forced to assume  
20 costs and burdens and risks that the railroads  
21 decide to shift to the captive shippers.

22 Ag shippers from farm producers rule

1 economies are particularly vulnerable.

2 Montana is the most captive state in the Union  
3 from a rail standpoint with BNSF controlling  
4 over 90 percent of the rail.

5 North Dakota's not much better.

6 Both states are too far from export facilities  
7 in the Pacific Northwest for trucking to be  
8 viable.

9 In many other states, many shippers  
10 are still too far from other railroads to  
11 avoid captivity by the BN. Even where the  
12 service by two railroads exist, the railroads  
13 choose not to compete.

14 There's little or no effective  
15 competition from other railroads or modes, and  
16 BNSF generally refuses to execute long term  
17 contracts for wheat and other agriculture  
18 commodities.

19 So allowing a write up for the URCS  
20 costs will reduce RVCs, and further delay the  
21 Board's recognition of BNSF's revenue  
22 adequacy.

1                   Statutory captive shipper  
2       protections have dwindled to the point of  
3       almost irrelevance during the last 30 years.  
4       And in this particular case, this would be  
5       dwindled further for no good reason.

6                   Will inclusion of the acquisition  
7       premium create efficiency? You've already  
8       heard. Won't.

9                   Many ARC members are industries that  
10      ship less than trainloads from thousands of  
11      origins and destination. And many others are  
12      large volume rail customers that ship between  
13      a few single origin and destination.

14                  What's common among them, they're  
15      all captive, and they have little railroad  
16      competition. Will the inclusion of this  
17      acquisition premium provide benefits or  
18      further rate increases for them?

19                  Let me talk a little bit about BN's  
20      attempt to wrap itself in the flags of GAAP  
21      and precedent: but Berkshire Hathaway, which  
22      actually paid the acquisition premium for

1       which the BN seeks to benefit has not  
2       supported BN's position in this proceeding.

3               And Berkshire Hathaway Chairman  
4       Warren Buffett warned against blind allegiance  
5       to GAAP. And that's in the witness Foss  
6       verified statement. The precedent BN sites  
7       are clearly distinguishable.

8               But if the Board finds in favor of  
9       the BN, it's decision in this case shown by  
10      similar acquisitions by larger acquisition  
11      premiums in the future.

12              Leveraging other peoples money is a  
13      powerful draw to the financial community, and  
14      is made more powerful when other people in  
15      question are captive customers.

16              Also, the Board needs to consider  
17      where the public interest lies. Is it served  
18      by facilitating more unchallengeable rate  
19      increases by the BN at a time when the BN has  
20      shown that it's ready, willing, and able to  
21      raise rates even without an \$8 billion write  
22      up, or is the public interest better served by

1 the decision which sets forth the acquisition  
2 is different from past acquisitions and which  
3 gives a small boost to the bargaining leverage  
4 of captive shippers of agriculture and other  
5 commodities. Thank you, and I'll turn this  
6 over to John.

7 MR. CUTLER: Thank you, and good  
8 morning. I'm John Cutler for Alliance for  
9 Rail Competition.

10 I have little to add to the comments  
11 Terry and Wayne made, and those made by WCTL  
12 and other shipper witnesses here this morning,  
13 and also in the written testimony. But I  
14 would like to add a few brief points.

15 First, BN claims that it ignores  
16 regulation when it sets rates. But there's an  
17 important admission in it's rebuttal argument.

18 I'm referring to Page 6, Footnote 10  
19 citing BNSF witness Lannigan as follows, I'm  
20 quoting, "In very limited instances, we might  
21 look at the RVC level of a specific rate, such  
22 as when a customer calls it to our attention

1 in a negotiation, or the even rarer instances  
2 where there appears to be a risk that we might  
3 be involved in rate reasonableness  
4 litigation."

5 Well, remember the context in which  
6 these negotiations take place. We're talking,  
7 by definition here, about captive shippers.  
8 Captive shippers don't have a lot of cards to  
9 play in negotiations with a market dominant  
10 railroad like BNSF.

11 I've been advising captive shippers  
12 for 35 years now. I can't think of a single  
13 one in which I haven't said you've got to hit  
14 the RVC level and you've got to bring up the  
15 possibility of a rate challenge at the STB.

16 In other words, the exception that  
17 BNSF witness Lannigan is referring to  
18 suggesting that RVC's are never a topic of  
19 conversation during these negotiations, well  
20 that's an exception on the order of the, other  
21 than that, Mrs. Lincoln, how did you like the  
22 play?

1           It's not really an exception at all,  
2           it's routine. Now, obviously when non-captive  
3           shippers are negotiating with the BNSF, there  
4           may be an entirely different set of discussion  
5           points.

6           But the focus of the Board today is  
7           the impact of this question on captive  
8           shippers, because that's your constituency as  
9           far as rail rate regulation is concerned.

10          There's another suggestion by BNSF  
11          that this only matters at the margin. It only  
12          matters when rates that would be above 180  
13          percent of variable cost would be shifted  
14          below 180 percent of variable cost.

15          Well, we've heard this morning that  
16          there are rate prescriptions out there tied to  
17          180 percent of variable cost that will  
18          obviously be affected to the tens of millions  
19          of dollars.

20          You suggested that those might be  
21          dealt with ad hoc in the individual decisions,  
22          but there are also an awful lot of shippers

1 out there who figure that the odds against  
2 them are too high if they challenge a rate at  
3 185 percent of variable cost.

4 So they take 220 or 250 sometimes.  
5 I mean, at some point, the pain becomes such  
6 that they just, you know, they say we've got  
7 to look at rate case here.

8 And you're still talking about  
9 moving RVC ratios from one level to a lower  
10 level, giving the false appearance that BNSF's  
11 rates aren't as high as they were without the  
12 acquisition premium.

13 More fundamentally, though, the holy  
14 grail, probably, for many of the ag shippers  
15 we represent here, who are small and isolated  
16 and can't bring \$5 million SAC cases, and for  
17 whom the three benchmark approach is  
18 undermined by the acquisition premium URCS  
19 costing. For many of them, the holy grail is  
20 the revenue adequacy constraint.

21 It's never been applied. We've all  
22 thought about how great it would be if the

1 railroad industry, or BNSF in this case,  
2 achieved revenue adequacy such that further  
3 differential pricing would have to be  
4 justified by BNSF.

5 At that point, you know, we don't  
6 yet know how the revenue adequacy constraint  
7 would work.

8 But we're seeing an acquisition in  
9 which BNSF has clearly shown its ability to  
10 attract capital, which is the ultimate  
11 question that the revenue adequacy test aims  
12 at.

13 And despite the fact that there  
14 couldn't be clearer evidence of BNSF's ability  
15 to attract capital on wall street, we have the  
16 revenue adequacy constraint receding into the  
17 horizon because of the possible URCS treatment  
18 of the acquisition premium.

19 The ag shippers we represent know  
20 about the STB. They have hopes that the STB  
21 will help them.

22 But the way that the \$8 billion

1 write up gets treated in this proceeding is  
2 going to be something that gives them some  
3 hope, or dashes those hopes as has been the  
4 case in the past.

5 Now, Vice Chairman Mulvey, you  
6 mentioned the point that these figures may be  
7 small, maybe it's 5 percent. So maybe it  
8 isn't that big.

9 But the problem the ag shippers we  
10 represent would fund on that front is it's  
11 part of a pattern. Over the years there have  
12 been cases after cases in which things go the  
13 railroad's way.

14 Some of these are driven by  
15 statutes, some of these are driven by policy.  
16 But add it all up, and the shippers lose here,  
17 the shippers lose there.

18 The barriers become layered against  
19 relief. And this is an occasion where there  
20 doesn't seem to be a reason to give the  
21 benefit of any doubt to BNSF. Thank you.

22 CHAIRMAN ELLIOTT: Thank you. Mr.

1 McBride?

2 MR. MCBRIDE: Thank you Mr.

3 Chairman, members of the Board. I am Michael  
4 McBride. I am here this morning on behalf of  
5 CURE.

6 I want to begin by addressing head  
7 on the concerns, Mr. Chairman, you and some of  
8 the other board members raised about legal  
9 issues.

10 The board is bound by the Rail  
11 Transportation Policy, which is a matter of  
12 statute in which uses words such as fair,  
13 accurate and reasonable.

14 You alluded to 49 USC 11161 which  
15 refers to GAAP. The statute, however, says  
16 that the board is only supposed to adhere to  
17 GAAP to the extent practicable.

18 The Board's predecessor, the ICC,  
19 when it adopted URCS and all of this is cited  
20 at Page 8 of my opening comments for The  
21 National Corn Growers Association, held that  
22 it was not bound by accounting standards, and

1       that it had so held in the productivity  
2       decision which is cited at that page of my  
3       comments.

4               Further, the statute to which you  
5       refer, Mr. Chairman, states that the board is  
6       to, "Periodically review it's cost accounting  
7       rules and shall make such changes in those  
8       rules, as are required to achieve the  
9       regulatory purposes of this part."

10              The regulatory purposes of this part  
11       are the rail transportation policy where I  
12       began, fair, accurate and reasonable.

13              Further, under 49 USC 10707(d)(1)(B)  
14       with respect to the calculation of the  
15       jurisdictional threshold, about which we've  
16       heard so much already.

17              The statute says that the Board is  
18       to use unadjusted costs calculated using the  
19       uniform rail costing system cost finding  
20       methodology, but, "with adjustments specified  
21       by the board."

22              So I think it is absolutely clear

1       that you have the authority to do the fair,  
2       accurate and reasonable thing here, which is  
3       not to include this premium in the railroad's  
4       uniform rail costing system, in the  
5       jurisdictional threshold, or in the revenue  
6       adequacy calculations.

7               Now let me also respond to a comment  
8       the Vice Chairman made about the Conrail case.  
9       I argued that case. You quoted the premium  
10      figures from the court's decision correctly.

11             That, however, is not the whole  
12      story. The Board told the 2nd Circuit and  
13      used those figures that you quoted in its  
14      decision, about seven and a half percent and  
15      five percent respectively.

16             However, what had not yet been told  
17      at that time, and I frankly wondered how the  
18      premium figures could be so small, because the  
19      premium was so large.

20             The Conrail transaction as approved  
21      at that time by the Board was structured as a  
22      lease. The assets were kept on the Conrail

1 books for the most part.

2 So the premium impact on CSX and  
3 Norfolk Southern as of the time of the Erie  
4 Niagara Rail Steering Committee decision in the  
5 2nd Circuit were very small percentage  
6 increases.

7 And the 2nd Circuit took due note of  
8 those, and also noted the fact that the Board  
9 said that there would be offsetting benefits  
10 for customers, and it therefore affirmed.

11 However, in about 2004 or 2005 in a  
12 little noticed transaction, suddenly the  
13 assets moved from the books of Conrail to the  
14 books of CSX and NS, and several billion  
15 dollars in asset values were added to CSX and  
16 NS's books at that time.

17 So the premiums, Mr. Vice Chairman,  
18 were much higher in Conrail. But in any  
19 event, the Board's decision as affirmed by the  
20 2nd Circuit was that customers would benefit  
21 because of the synergies.

22 You asked about synergies, and I

1 think the Vice Chairman or the Chairman did as  
2 well. I can assure you, I argued several of  
3 those cases.

4 In every single one of them, the  
5 merging railroads came before the Board and  
6 their counsel said that the mergers would  
7 result in more single line service and  
8 customers would benefit from the single line  
9 service.

10 Those were the synergies, as well as  
11 in some cases they claimed there would be  
12 lower rates resulting. For example, in  
13 Conrail because of the joint asset area.

14 Or the so called vigorous  
15 competition that would result from the  
16 trackage rights that BNSF got in the UPSP  
17 merger.

18 Over and over again, those  
19 transactions were "justified" before this  
20 Board and its predecessor because of the  
21 claimed benefits to the customers from the  
22 transactions.

1           This case is fundamentally  
2           different. BNSF is no different today than it  
3           was before the acquisition of Berkshire  
4           Hathaway. There are no synergies.

5           There weren't any in the prior  
6           transactions, either, as they turned out. But  
7           those were the claims on which the Board  
8           approved those transactions. There are no  
9           such claims here.

10          I submit to you that the statute  
11          requires you to leave this premium out if  
12          you're going to be fair, accurate and  
13          reasonable, and your precedents don't stand in  
14          the way.

15          The competitive rates in the  
16          marketplace will be completely unaffected by  
17          this transaction. I think everybody agrees  
18          with that. So why are we here?

19          Well, by process of elimination, the  
20          only reason we're here is because Berkshire  
21          Hathaway's premium is being included in BNSF's  
22          costs, even though BNSF didn't bear those

1 costs, so that captive shippers will pay more.

2 Mr. Chairman, there is a direct  
3 impact when you set rate prescriptions based  
4 on revenue variable cost ratios, because it is  
5 undisputed that the premium will have a  
6 significant impact on the uniform rail costs  
7 of BNSF.

8 BNSF said the figure was 5.6  
9 percent. When you multiply 5.6 percent by 180  
10 percent, the jurisdictional threshold, the  
11 average impact according to BNSF's numbers  
12 would be 10.08 percent.

13 So effectively, not only would Basin  
14 pay more because its rate was set at about 240  
15 percent of variable costs, and those variable  
16 costs would go up, but if a rate is set as an  
17 AEPCO at the jurisdictional threshold, what  
18 was 180 today would be 190.08 percent  
19 tomorrow.

20 So everybody's impacted, not just  
21 Basin and AEPCO. And they're further impacted  
22 because people like Mr. Hurst and people Mr.

1 Whiteside speak for can't even come before the  
2 Board for relief if their rates fall below 190  
3 or so percent, if you allow this premium to be  
4 passed through.

5           You know, some people have accused  
6 me of being present when Grover Cleveland  
7 signed the Interstate Commerce Act. I wasn't,  
8 but I'll tell you what he said. I was  
9 reminded of it when I saw Mr. Hurst here this  
10 morning.

11           He said, "Now that I've signed this  
12 bill, every farmer in America will know that  
13 they can come to Washington and bring their  
14 problem to the Interstate Commerce Commission  
15 and go home secure in the knowledge that it  
16 will be taken care of."

17           Well, that's why we're here. And  
18 you can fix this problem.

19           BNSF's witnesses Colby and Neels, by  
20 the way, candidly conceded. Now these are  
21 eminent regulatory economists. They believe  
22 in acquisition premiums because they believe

1       in fair market value.

2               So they're on BNSF's side of that,  
3       don't get me wrong. But they conceded at Page  
4       20 of their testimony that if you use written  
5       up asset values for premiums, if you use fair  
6       value, you have to use the real, not the  
7       nominal cost of capital.

8               And Brandeis got into this in his  
9       famous dissent in the Southwestern Bell  
10      Telephone case criticizing the use of fair  
11      value, which the Supreme Court had held was  
12      required up until that time because of the  
13      infamous Smyth v. Ames case.

14              And Brandeis explained that if you  
15      go to fair value, you're exchanging the known  
16      of book values for the unknown of fair values.

17              And armies of accountants and  
18      lawyers and economists would troop before the  
19      regulatory agencies arguing every year about  
20      what the fair value was.

21              So you not only had the unknown of  
22      the fair value, but you had a second unknown,

1       which was the real instead of the nominal cost  
2       of capital.

3               It deviled rate making for many,  
4       many years until the Supreme Court held  
5       relying on Brandeis' dissent in the  
6       Southwestern Bell Telephone case and FPC vs.  
7       Hope Natural Gas Company, that book values  
8       could be used.

9               Every other regulatory commission in  
10      this country that I'm aware of uses book value  
11      to regulate the regulated entities under its  
12      jurisdiction because of Hope.

13              You should, too, because the numbers  
14      are fair, they're accurate, they're reliable,  
15      they're reasonable. You're required to do  
16      that under the rail transportation policy.

17              The prior merger decisions do not  
18      stand in the way. We plead with you. If you  
19      looked at the premium figures that Mr. Crowley  
20      laid out, it went from 90 million in  
21      Blackstone. Nobody complained there was no  
22      precedent, upwards, upwards, upwards several

1 billion dollars to the premium here.

2 There is no end unless you put a  
3 stop to this now. Thank you.

4 CHAIRMAN ELLIOTT: Thank you, Mr.  
5 McBride. Vice Chairman?

6 VICE CHAIRMAN MULVEY: Thank you.  
7 BNSF, in its testimony, downplays the amount  
8 of traffic that will be affected by inclusion  
9 of the acquisition premium.

10 But if some, and perhaps a not  
11 insignificant percentage of BNSF's traffic,  
12 let's say as much as eight percent, would lose  
13 the ability to qualify to become a rate case  
14 simply because of the acquisition.

15 Is that a sufficient reason for the  
16 Board not to use GAAP, purchase accounting or  
17 to somehow modify it's use?

18 And what should we do if we knew  
19 (and could identify) that the acquisition  
20 premium would fall particularly heavy on  
21 certain groups of shippers, such as farmers?

22 In fact, in it's written testimony,

1 the USDA specifically expressed those  
2 concerns. Would you care to comment on that?

3 MR. MCBRIDE: I'll be happy to  
4 start. 49 USC 10707(d)(1)(B) in my view  
5 requires that you make sure that the  
6 jurisdictional threshold is not adjusted, in  
7 effect, upwards by the inclusion of this  
8 premium as I read to you earlier.

9 That determines whether people can  
10 come before this Board or not, as you well  
11 know. And the Board is permitted, indeed  
12 required I submit, to make adjustments as are  
13 specified by the Board to account for  
14 consistency with the rail transportation  
15 policy.

16 I cannot imagine, although  
17 Commissioner Begeman was there and I wasn't,  
18 but I cannot imagine that Congress ever  
19 thought that the jurisdictional threshold of  
20 180 percent set by law could be manipulated,  
21 if you'll forgive the pejorative, adjusted if  
22 you prefer, by the actions of a financial

1 holding company paying an arbitrary premium  
2 and adjusting the jurisdiction of the Board by  
3 its own actions without the Board even having  
4 had the authority to approve the transaction.

5 This never came before this Board.  
6 And BNSF, by the way, would have you believe  
7 that when Mr. Buffett went to see Mr. Rose in  
8 a conversation that I'm told took no more than  
9 15 minutes when Mr. Buffett already owned more  
10 than 20 percent of BNSF.

11 And he ended up offering \$100 a  
12 share for the remaining shares. And the deal  
13 was struck, that that somehow was an arms  
14 length transaction leading to a market  
15 determination of the value of the stock. Who  
16 is kidding whom?

17 There is not a person in America for  
18 which that could be less of an arms length  
19 transaction than Mr. Buffett at that point  
20 being the largest shareholder, I believe, of  
21 BNSF at the time, and in any event, being Mr.  
22 Buffett.

1           So my point simply is, Mr. Vice  
2           Chairman, I do not believe Congress intended  
3           this board's jurisdiction to be subject to the  
4           whims of the premiums paid by people who  
5           choose to acquire railroads.

6           Congress set the threshold. I think  
7           it expected you to hold to that threshold.

8           VICE CHAIRMAN MULVEY: You mentioned  
9           a couple of the cases, AEPCO and others, and  
10          that the awards would have been reduced if we  
11          included the acquisition premium.

12          Weren't those awards expressed as an  
13          absolute amount of dollars, and that we could  
14          adjust the RVC ratio to accommodate the change  
15          and still give the beneficiaries the same  
16          payout?

17          MR. MCBRIDE: If I understand your  
18          question correctly, at the end of all those  
19          adjustments and calculations that Mr. Leseur  
20          and Mr. Crowley talked about earlier, Basin  
21          was prescribed a rate about 240 to low 240's  
22          depending on the year. And, you know, we

1 don't have to quibble about the exact number.

2 But it was stated as a revenue  
3 variable cost ratio. And those rates would  
4 change from time to time under the Board's  
5 prescription, depending on what BNSF's uniform  
6 rail costs were, or variable costs resulting  
7 from the URC system would be.

8 And since you have now, for at least  
9 the moment, allowed the acquisition premium to  
10 effect upwards those uniform rail costs, the  
11 variable costs of BNSF have increased.

12 And without action by the Board,  
13 without some offset to protect Basin, as I  
14 understand your prescription that stays at 240  
15 or low 240's of variable costs that have been  
16 increased by this premium, then the allowed  
17 rate that BNSF can charge increases and the  
18 relief that Basin gets decreases.

19 VICE CHAIRMAN MULVEY: Well, that's  
20 what I was saying. That, in fact, the Board  
21 could act to offset that by changing the  
22 revenue and variable cost ratio so that they

1 received the same absolute dollar benefit.

2 MR. MCBRIDE: Sure you could. But  
3 if you did that, I don't know why you wouldn't  
4 do it for every other captive shipper in the  
5 same boat. It's the same principle.

6 We're here talking about principles.  
7 Not particular shippers. I'm happy if you  
8 take care of a particular shipper. But as far  
9 as I'm concerned, this is the most fundamental  
10 principle, frankly, that you have before you  
11 today.

12 You can quibble about a lot of other  
13 things, but this is so arbitrary, this is so  
14 enormous. And the impact of this policy is so  
15 profound because tomorrow, somebody else could  
16 come in here with an even larger premium.

17 And if you hold that your hands are  
18 tied, or that we're only going to protect the  
19 shipper who happened to have gotten through  
20 the door before the monopolist or the holding  
21 company comes in here, you know, with an even  
22 larger premium, God help us because everybody

1       else in America will not get the relief that  
2       was intended when Grover Cleveland signed that  
3       statute.

4               VICE CHAIRMAN MULVEY: Well, you and  
5       I were both there when President Cleveland  
6       signed that statute, so let me continue on  
7       that a little bit. It's also true that it has  
8       been the agricultural community that, in fact,  
9       was the driving force in having the ICC  
10      created.

11             In fact, the ICC Act was preceded by  
12      the Grange Laws back in the 1870's, which for  
13      a number of reasons, failed to be successful  
14      and were eventually replaced by a federal law  
15      after several commissions examined it, and  
16      after about a ten year period, finally  
17      Congress came up with the IC Act.

18             But it was the nation's farmers'  
19      interests that were of a special concern. And  
20      we've heard today that farmers continue to  
21      feel aggrieved. Therefore, I have two  
22      questions.

1           One, is there any evidence that  
2 farmers have been driven out of business  
3 because of higher rail rates?

4           That rail rates, per se have been  
5 the reason for some farmers to have been  
6 forced to give up farming?

7           And secondly, we did make some  
8 changes to our procedures recognizing that the  
9 stand alone cost approach was very time  
10 consuming and very expensive.

11           So, we inaugurated the simplified  
12 SAC approach and the three benchmark approach,  
13 which were designed, and I wouldn't say  
14 specifically, but certainly with farmers in  
15 mind, with agriculture shippers in mind giving  
16 them an avenue to bring a case before the  
17 board.

18           And yet we have not had farmers or  
19 agricultural shippers bringing cases before  
20 the board. So would you comment on both of  
21 those? One, the what is happening in the farm  
22 community because of rail rates.

1                   And two, why haven't we had more  
2                   cases brought under our simplified and three  
3                   benchmark approaches which were thought to be  
4                   helpful to the agriculture community. Thank  
5                   you.

6                   MR. WHITESIDE: Okay, if you don't  
7                   mind, I'll take a first crack and let Wayne  
8                   take the second crack at it.

9                   Have farmers gone out of business  
10                  because of the freight rates? No, but what  
11                  we've seen is them change crops. We've seen  
12                  them, for example, move to crops that they can  
13                  truck.

14                 A lot of them, for example, most of  
15                 our pulse crops in Montana are being trucked  
16                 up to Canada because we can't get the  
17                 intermodals, the railroads to stop. So they  
18                 just have changed crop.

19                 The other thing that happens is that  
20                 we see a rotation change in the crops where  
21                 they can ship to local markets instead of  
22                 continuing to move into index four channels.

1           Have the railroads got to the point  
2       where they've priced them out of business?  
3       You know what the real issue is here, and it  
4       will always continue to be the issue, it's a  
5       profit that's held on the farm that the  
6       railroads want, and so they take part of it.

7           And that's what the issue continues  
8       to be is to how much should be theirs, how  
9       much should be ours in the market of fairness.  
10      And I think that's the wrestling that we do.

11           It isn't a matter of today yet  
12      driven out of business. My gosh, if they  
13      drove us out of business, what good would that  
14      do them? And that's always their argument.

15           But it's pricing at the levels where  
16      we can't pass it on to our kids, or we can't  
17      regenerate the farm. Those kind of issues do  
18      happen. We're seeing consolidations of farms  
19      rather than continuing in the families.

20           Those kind of things could generally  
21      be associated with transportation. The other  
22      thing to remember is that in a large number of

1 cases, some of our suppliers are running into  
2 trouble.

3 And, for example, some of them that  
4 have left Idaho, had left stating it's the  
5 transportation costs that drove us out.

6 And so you can look at the farm, but  
7 you can also look at some of the input costs,  
8 and they have risen substantially because  
9 they've not been able to, you know, to stay in  
10 the market. Do you want to address that a  
11 little bit?

12 MR. HURST: Yes. I think Terry's  
13 nailed it pretty well. Right now we are  
14 enjoying higher commodity prices than we have  
15 in the last 30 years.

16 And so right now, our margins for  
17 most of us farmers that have production, you  
18 know, if drought is taken out and so forth, we  
19 are enjoying good times.

20 But for most of our careers, I've  
21 farmed for over 30 years full time, and most  
22 of the time my margins were very, very slim,

1 and transportation costs, the excess that I  
2 figured definitely effected my bottom line and  
3 my ability to survive, I and my neighbors. So  
4 it's a cumulative effect.

5 MR. WHITESIDE: I think you'll also  
6 see that the smaller farmers have been driven  
7 out. And that's a continuing problem.

8 As that consolidation occurs, we can  
9 only come back to it as, one of the things  
10 that Wayne talked about is having hired hand.  
11 You have to today. You have to have them  
12 large enough so you can have hired hands to be  
13 able to make money.

14 VICE CHAIRMAN MULVEY: But it's also  
15 true that the size of the average farm has  
16 grown and the number of small farmers and the  
17 percent of small farmers has been declining  
18 for more than a century.

19 So this is not something we can  
20 point to the recent activities of the  
21 railroads. This has been going on for a long  
22 time for a lot of reasons.

1                   MR. WHITESIDE:  It's the nature of  
2                   the beast that's going on, yes.

3                   VICE CHAIRMAN MULVEY:  But you're  
4                   saying it's accelerated at the margin by  
5                   railroad actions?

6                   MR. CUTLER:  Right.  Also, Vice  
7                   Chairman Mulvey, you had asked about the rate  
8                   relief options.

9                   The agriculture community  
10                  appreciates the fact that there are options  
11                  other than SAC, with some discomfort about the  
12                  fact that it took 16 years to even come up  
13                  with the first non-coal guidelines.

14                  But there are a couple of problems  
15                  with the three benchmark.  And as for  
16                  simplified SAC, I think the main reason it  
17                  hasn't been tried in small rate cases that we  
18                  hear from consultants that it's almost as  
19                  expensive as full SAC.

20                  With three benchmark, it's cheaper  
21                  and faster.  But it's still too expensive for  
22                  many farmers to tackle.  The relief cap is two

1 low.

2 And the third problem is that in a  
3 state like Montana where a single railroad  
4 dominates the entire state, it's easily  
5 neutralized because your comp group may be  
6 every other farmer in the state, but if every  
7 other farmer in the state is paying the same  
8 tariff rates, how do you show that you're an  
9 outlier?

10 The way the rate relief provision is  
11 set up works against many in the West, and  
12 specifically under BN. And that raises a  
13 larger point, which I would like to make,  
14 picking up on Mike McBride's comment about  
15 fundamental principles.

16 There's an asymmetry that sometimes  
17 gets overlooked. I would hate for this case  
18 to be seen as if we go BNSF's way, it makes  
19 more money, if we go the shippers way, BNSF  
20 makes less money.

21 BNSF makes more money either way.  
22 The relief we're asking for doesn't tie BNSF's

1 hands at all. All it does is give shippers  
2 who are so inclined a shot at negotiating  
3 better rates as a private sector solution.

4 Or possibly, though rarely, coming  
5 before the USTB or Congress and saying look,  
6 here are the facts, here are the numbers.  
7 Something needs to be done.

8 But we're not taking any money away  
9 from BNSF when you decide in favor of not,  
10 well I mean, maybe in Western Fuels you are.

11 But broadly, in the aggregate, BNSF  
12 remains free to raise rates on all of it's  
13 shippers who aren't subject to a rate  
14 prescription to make up whatever loss it might  
15 have if you adjust the Western Fuels rate  
16 prescription.

17 MR. HURST: And Mr. Vice Chairman, I  
18 just wanted to add that the McCarty Farms  
19 litigation was litigation brought by farmers,  
20 despite the terminology. It was even before  
21 your time here.

22 And despite the fact that they got

1       some relief, the D.C. Circuit overturned that  
2       relief.

3               And I think there were a lot of  
4       discouraged people after all the years and all  
5       the money that was spent on that litigation,  
6       to end up with nothing. I think that may  
7       account for, also, the fact that you haven't  
8       seen as many of them in recent years.

9               VICE CHAIRMAN MULVEY: Yes, McCarty  
10       Farms was the first of our SAC cases and the  
11       last one that involved the agricultural  
12       community.

13              MR. WHITESIDE: And it was 16 years.  
14       And one more thing, I think, that's important.  
15       When you look at three benchmark from a farm  
16       standpoint, very difficult to find because  
17       farm producers may not have standing. We  
18       don't know yet in front of this board.

19              If they don't, then it's virtually  
20       impossible to find a grain company that will  
21       allow us to bring a case. We found that out  
22       with the Attorney General in Montana.

1           The other thing is that the grouping  
2           that you have to do in three benchmark means  
3           we're going to start at 240, 250, maybe even  
4           higher.

5           And of course, if they raise all the  
6           rates, your starting point is much higher.  
7           And so your relief is not adequate to be able  
8           to bring them.

9           CHAIRMAN ELLIOTT: Commissioner?

10          COMMISSIONER BEGEMAN: Could you  
11          comment on the premium level itself and BNSF's  
12          calculation of it?

13          MR. MCBRIDE: Thank you for asking  
14          that question, because there are at least two  
15          empty chairs in this room today. Number one,  
16          we have no witness from Berkshire Hathaway,  
17          which is curious, because Berkshire Hathaway  
18          paid the premium.

19          Number two, we have testimony from  
20          BNSF's CFO, Mr. Hund, who testifies that there  
21          was no in-house expertise in terms of  
22          determining how much of this premium that was

1       paid should be allocated to assets and how  
2       much to good will and to which assets?

3               So they went out and hired  
4       accounting firms to do that work for them.  
5       And the accountants aren't here.

6               So frankly, I find it very troubling  
7       that a premium on the order of \$22 or \$23  
8       billion was paid depending on how you account  
9       for liabilities.

10              We end up with \$8.1 billion, which  
11       seems like an arbitrary number allocated for  
12       regulatory purposes to the net investment base  
13       and to go into URCS.

14              It's spread across assets in a  
15       disproportionate way, that is to say not  
16       uniformly. But some assets go up, there are  
17       some that even went down.

18              We don't know how these accountants  
19       did that. We don't know why Mr. Buffett  
20       thought the amount of the premium that he  
21       decided to pay was appropriate. The Board  
22       never passed on that.

1                   We have a lot of unknowns here. And  
2                   if I were in your shoes, I would find it very  
3                   troubling that we don't have any better  
4                   explanation for these amounts.

5                   COMMISSIONER BEGEMAN: But other  
6                   than sort of a lack of explanation, do you  
7                   have any type of real concrete information?  
8                   Is some of it inaccurate as to how they  
9                   approached it?

10                  MR. MCBRIDE: Well, we don't know  
11                  about each asset. But we have not challenged,  
12                  Mr. Leseur answered this and I think he  
13                  answered it correctly, that we have not  
14                  challenged for these purposes that BNSF's  
15                  accountants determined that \$8.1 billion was  
16                  the right number.

17                  I'm not saying I know it's the right  
18                  number. I don't know how they got there. But  
19                  we haven't challenged that because it doesn't  
20                  seem to me that, frankly, if I were in your  
21                  shoes, the answer would be any different if it  
22                  were seven, eight or nine out of the 23.

1           But I do want to comment, you know,  
2           putting it into larger context, if that might  
3           be helpful for you, because I think that, as  
4           a policy maker sitting where you are, is the  
5           really key issue.

6           Go back to Mr. Crowley's slide. \$90  
7           million at the time of Blackstone's CNW,  
8           nobody even challenged it. So there was no  
9           decision, no precedent.

10          Then we got to \$1.4 billion. Then  
11          we got to \$2.3 billion. Then we got to over  
12          \$3 billion in the UP, C&NW, Atcheson, Topeka,  
13          Santa Fe, BNSF and UP/SP mergers. And finally  
14          to Conrail.

15          According to the regulatory  
16          estimate, Conrail was over \$3 billion. The  
17          actual premium paid was closer to ten when you  
18          take into account the debt that was assumed.

19          So we've gone from \$90 million to at  
20          least \$3 plus billion, maybe \$10 billion  
21          depending on how you measure it in Conrail.  
22          And now we're over \$20 billion.

1           And the railroads, at least AAR  
2       takes the position, you don't even have the  
3       authority to do anything about it. BNSF  
4       doesn't seem to argue that. It concedes you  
5       do, it just says you shouldn't. But what --

6           COMMISSIONER BEGEMAN: Do you agree  
7       with Mr. Wilson as far as what the value of  
8       BNSF is?

9           MR. MCBRIDE: Value to whom? You  
10      know, as Brandeis said, value is a word of  
11      many meanings. It was obviously worth it to  
12      Mr. Buffett.

13           If you read his letters to  
14      shareholders as I have, he refers to BNSF as  
15      one of his fabulous five.

16           He led his shareholder's letter in  
17      February of 2011, referring to 2010, he led  
18      off with his discussion about what a fabulous  
19      acquisition BNSF was and that it had returned  
20      an even greater profit for Berkshire Hathaway  
21      than he had anticipated.

22           That's saying something, since he's

1       pretty good at anticipating. So, you know,  
2       from Mr. Buffett's point of view, it's been a  
3       spectacular buy and very profitable.

4               But that just goes to show you, it  
5       seems to me, that there are a lot of rents  
6       here, as the Vice Chairman might refer to  
7       them. You know, and the issue really is for  
8       the captive customers, who gets all the rents?

9               Is it whatever, you know, richest  
10      guy in America comes in and buys a railroad  
11      and then gets to write up the asset values and  
12      then say I get to raise the jurisdictional  
13      threshold and the rates on the captive  
14      customers?

15              Or is it the Board that gets to say,  
16      well now, wait a minute. We're not going to  
17      just let you come in here and put any premium  
18      you want on a transaction.

19              So value to whom? To me, the value  
20      of the assets, the value of the assets should  
21      be determined on a book value basis. The  
22      Supreme Court said that was constitutional in

1 Hope. You generally use book values.

2 The problem is that when these  
3 premiums have been paid, you have allowed  
4 those to affect upwards the book value of the  
5 assets. And that's where the revenue adequacy  
6 calculation has gone wrong.

7 That's where Professor Kahn  
8 explained everything's gone haywire. And  
9 that's where these pernicious impacts on URCS  
10 and the variable costs and the jurisdictional  
11 threshold then flow through.

12 So the value to me, for regulatory  
13 purposes, is book value coupled with the  
14 nominal cost of capital treats the railroad  
15 fairly. That's fair value to me.

16 To them, fair value is whatever  
17 somebody pays for the assets that they can get  
18 some accounting firm to say is the amount that  
19 the asset should be upward adjusted without us  
20 even having the methodology that they used to  
21 do that.

22 I'm sorry, I don't see how you could

1 sit here and approve a methodology that they  
2 haven't even sought to explain or justify as  
3 opposed to book value. I think you ought to  
4 stick with book value. I think that's the  
5 right value.

6 COMMISSIONER BEGEMAN: Can any of  
7 you comment on how rates have changed for you  
8 over the last two years? Wayne?

9 MR. HURST: You know, I've been in  
10 meetings a few times with the railroads,  
11 including BNSF. And I tend to believe that,  
12 well to a point, that this doesn't affect much  
13 of how they set the rates.

14 They view it as a business and their  
15 ability to capture profit. And they want a  
16 return and visiting with other railroads, they  
17 justify it internally and externally to the  
18 people they seek capital and also, you know,  
19 within their management that okay, we need  
20 such and such return.

21 And that kind of drives how they set  
22 the rate to a large degree. But yet it's kind

1 of like, I see it as the regulatory  
2 environment, and Mr. Buffett looked at it,  
3 just like you would on a long open highway in  
4 the U.S. is marked speed limit 55.

5 But if everyone knows that the local  
6 sheriff isn't going to stop you below 75,  
7 you're going to go 75. Mr. Buffett knew that,  
8 hey, he had a chance to make some money, I  
9 believe. And so that's why it was done.

10 And I think you're sending out a  
11 clear signal to anyone else that okay, we'll  
12 let you make these investments and pay  
13 whatever you're going to pay.

14 And the rate payer, ultimately, will  
15 pay for it. And I think that's the  
16 environment they're operating in.

17 MR. WHITESIDE: Looking back, I  
18 would have to go back and check to make darn  
19 sure, but I think we've seen two major rate  
20 increases on the Burlington Northern since  
21 February of 2010, and that was one of the  
22 other questions by one of you all.

1           We've not seen any at the UP. That  
2           doesn't mean we won't see them before the  
3           shipping season. But we've not seen them at  
4           the UP.

5           So the rates right now are the  
6           highest they've ever been, even without fuel.  
7           And then take the fuel, it just skyrocketed.

8           So now, the one thing that the BN  
9           has done in the last few years is done some  
10          adjustments on in the northern tier states so  
11          that they aren't much higher than other  
12          states.

13          They've raised some of the other  
14          states is how they've done that. But so the  
15          disparity that we saw before isn't there, but  
16          they're continuing to increase at kind of  
17          major levels right now.

18          And there seems to be no end to it.  
19          A lot of that earlier in 2010 was because the  
20          grain prices were up and they wanted to get  
21          their fair share of that.

22          The problem is that when they fall

1 back, then of course, rail rates don't go  
2 back. But they're the highest they've ever  
3 been.

4 COMMISSIONER BEGEMAN: Do you have  
5 any statistics on the level of currently  
6 captive shippers in the ag community that  
7 would no longer be captive?

8 What percentage of folks in  
9 agriculture could currently bring a rate case  
10 that would no longer be able to if the premium  
11 stays in?

12 MR. WHITESIDE: Well, it would be  
13 the opposite, I think. Wouldn't it? That  
14 what happens is if they put the premium in  
15 there, then it's going to raise the cost of  
16 the revenue to variable cost levels relative -  
17 -

18 COMMISSIONER BEGEMAN: Right, so  
19 fewer will be captive.

20 MR. WHITESIDE: Got you, okay. You  
21 know, I haven't done the studies, but we could  
22 sure do them and submit them to the record.

1 At least take a quick cursory look at it for  
2 you, if that would be --

3 COMMISSIONER BEGEMAN: I was just  
4 curious if you had done that. John?

5 MR. CUTLER: But part of the problem  
6 there is that it's not always 180 percent. I  
7 mean, an awful lot of grain rates are well  
8 above 180 percent of variable cost.

9 And, you know, shippers don't file  
10 rate cases. You know, the railroads will tell  
11 you that's because shippers aren't that  
12 unhappy about things.

13 I think it's more a matter of  
14 shippers being very unhappy about things, but  
15 questioning whether they have the money or the  
16 hope of success that would justify a rate  
17 case.

18 And I think even when I worked with  
19 utility coal shippers, nobody thought that 181  
20 percent was the right point at which to file  
21 a rate case.

22 The feeling was always, well, you

1 know, 200 percent, 210 percent, 220 percent.

2 That's where you're starting to talk about  
3 pain thresholds, rising to the level of let's  
4 sit down and talk to the railroad about the  
5 RVC levels and about the fact that we may be  
6 forced to file a challenge of the STB.

7 MR. MCBRIDE: Commissioner Begeman,  
8 we attempted to provide you with a number. I  
9 don't know if it's the right number, but it's  
10 the best we could do in our reply comments for  
11 CURE at Page 2.

12 We noted that BN itself claimed that  
13 the amount of traffic that would fall below  
14 the jurisdictional threshold if the premium  
15 were included would be about two percent of  
16 BNSF's total traffic.

17 We went on to say it could be  
18 higher. The difficulty here, and why it's so  
19 hard for me to answer your question is the  
20 confidential way bill sample, which is  
21 submitted to the Board is not available to us  
22 until and unless we file a rate case.

1                   And then we get it only under  
2                   protective order. But your staff could tell  
3                   you, if you looked at the traffic between 180  
4                   and 190 percent --

5                   COMMISSIONER BEGEMAN: I was just  
6                   curious if you had --

7                   MR. MCBRIDE: Yes, I can't do better  
8                   than the numbers that BNSF gave you. But what  
9                   I can tell you is over the last ten years,  
10                  rates have been rising steadily and well above  
11                  inflation.

12                  And the latest public data we have  
13                  in the aggregate shows that that was true  
14                  through 2010. We don't have the 2011 data  
15                  yet.

16                  MR. HURST: I just might add,  
17                  getting back to their philosophies, and we  
18                  understand this because we invest a lot of  
19                  money ourselves for productivity and  
20                  increased, you might say, enhanced service.

21                  They'll say that we need to reinvest  
22                  money and provide you with the service that

1       you need. And so it takes so much to do that.  
2       And so that's why they raise their rates.

3               I think most of us wold be tickled  
4       to have 180 percent, frankly. So you asked  
5       the question, I mean gee whiz. I mean, most  
6       of us are well above that.

7               CHAIRMAN ELLIOTT: Just a few  
8       questions. Mr. McBride mentioned some of the  
9       RTP and listed three, I guess, factors that  
10      should be considered, accuracy, fairness and  
11      reasonableness.

12              And I'm not sure, but I might be  
13      hearing two different things from the two  
14      shipper panels with respect to accuracy.

15              I believe when I asked the prior  
16      panel about accuracy, that they thought  
17      purchase accounting, in itself, was the most  
18      accurate way to value the company as opposed  
19      to, you know, cost accounting.

20              Does this panel agree that purchase  
21      accounting is the most accurate way to value  
22      it, the company?

1           MR. MCBRIDE: The earlier panel  
2 mentioned that GAAP would indicate that  
3 purchase accounting is accurate for accounting  
4 purposes. They also indicated that using  
5 historic values, book values was accurate for  
6 regulatory purposes.

7           My point to you is I'm not here to  
8 try to justify our position on the basis of  
9 accounting because I don't think you're bound  
10 by accounting and the D.C. Circuit has said  
11 that.

12           My point to you is that I think the  
13 premiums that have been paid have been going  
14 steadily upward from \$90 million to \$23  
15 billion over the last two decades of these  
16 transactions, in part because of your policy  
17 here.

18           And there's no showing in my  
19 estimation that \$23 billion was, other than an  
20 arbitrary amount that was arrived at by Mr.  
21 Buffett because he didn't want to argue with  
22 Mr. Rose about what he was going to pay for

1 the stock, because it was still worth it to  
2 him.

3 And the \$8 billion that the  
4 accountants have derived comes out of some  
5 black box that hasn't been explained.

6 And so Mr. Chairman, I can't sit  
7 here and tell you that 23 billion or 8 billion  
8 are accurate numbers because they're, as far  
9 as I'm concerned, numbers out of the black  
10 box.

11 We aren't challenging the exact  
12 level of those numbers for purposes of this  
13 transaction because Mr. Leseur explained to  
14 you what we got in discovery and what we  
15 didn't get.

16 And we didn't think the exact value  
17 of these numbers was going to affect the  
18 outcome, or we might have made an even bigger  
19 fight about it.

20 But no, I'm not going to tell you  
21 that I think \$23 billion is an accurate  
22 measure of anything besides what Mr. Buffett

1 was willing to pay.

2 It certainly wasn't approved as an  
3 appropriate premium by this Board. And the  
4 same goes with the \$8.1 billion. I think  
5 they're arbitrary, quite frankly.

6 CHAIRMAN ELLIOTT: What about, with  
7 respect to the \$100 a share, I thought I heard  
8 you kind of questioning earlier in your  
9 testimony whether or not that was arms length.

10 Do you believe that, I mean, two  
11 groups that are as sophisticated as BNSF and  
12 Berkshire Hathaway would do anything except  
13 for an arms length transaction?

14 MR. MCBRIDE: I don't quite agree  
15 that that's what happened. I don't think it  
16 was arms length to have your largest  
17 shareholder come in and say this is what I'm  
18 willing to pay, take it or leave it.

19 So I understand it, the BNSF board  
20 tried to push a little harder and he wouldn't  
21 agree. And so the \$100 was what he put on the  
22 table.

1           But how do we know that BNSF didn't  
2           have some investment bank that looked at it  
3           and said gee, you know, he could have gotten  
4           away with \$90 a share, and we might have taken  
5           that.

6           I mean, the point is that he picked  
7           the number, he thought it was a reasonable  
8           investment as far as he was concerned because  
9           so much of the railroad is unregulated and  
10          they can run themselves the way they want to.

11          Very little of it is regulated by  
12          this Board. For all I know, they had legal  
13          advice that said oh gee, based on the  
14          precedent, we might even be able to sneak some  
15          premium into the regulated rates.

16          But what the value is to him for the  
17          stock and what you should be determining the  
18          value to be of these assets for regulatory  
19          purposes are two entirely different things.

20          And so I am not going to agree that  
21          whatever number that they arrived at was  
22          either arms length or fair because nobody's

1       determined that it was fair.

2               They never asked you to determine  
3       whether it was fair, or anybody else. It was  
4       fair to him and Berkshire Hathaway. Fine,  
5       that's not my problem. We don't challenge  
6       that.

7               They can spend whatever money they  
8       want for stock. It doesn't bind you. It  
9       doesn't affect, necessarily, the value of  
10      those assets. You're here to determine  
11      independently what the value of those assets  
12      are.

13              But I will not accept that that was  
14      an arms length transaction. Seems to me it  
15      was as far from it as it could be.

16              I think all we know is that the BNSF  
17      board of directors decided that \$100 a share  
18      was a good price for their shareholders. But  
19      that doesn't mean it was a good price for  
20      their regulated customers.

21              CHAIRMAN ELLIOTT: And do the other  
22      panelists have any comment on that. Okay.

1 And then we get toward to the reasonableness  
2 of it, I guess was the next standard that you  
3 raised in the RTP.

4 With respect to reasonableness, and  
5 I asked the same question to the prior panel,  
6 my understanding is that some shippers early  
7 on, when we were addressing these issues back  
8 in the late '80s especially, had argued the  
9 opposite way, that acquisition accounting is  
10 the most effective and appropriate method to  
11 deal with these types of matters.

12 And has there been anything, I  
13 guess, that has changed since then that would  
14 have changed your mind on why we've gone from  
15 supporting acquisition to the cost accounting?

16 MR. MCBRIDE: I would be happy to  
17 start by saying that in fact, this goes back  
18 to 1898. And the customers argued at that  
19 time for --

20 CHAIRMAN ELLIOTT: Do you have  
21 another Grover Cleveland quote on that?

22 MR. MCBRIDE: Smyth v. Ames, it was

1 Williams Jennings Bryan, actually, who argued  
2 the case for the farmers.

3 And they argued for fair market  
4 value because the value of the assets were  
5 below book at the time of the railroads argued  
6 for book. So you know, people have changed  
7 positions over time.

8 And you're quite right, Mr.  
9 Chairman, that at the time that the Board  
10 approved, I should say the ICC approved in the  
11 case that AAR took to the D.C. Circuit, the  
12 use of acquisition value when it was lower  
13 than book, there were some shippers who  
14 supported the Board on that.

15 I can sit here and tell you, look  
16 you straight in the eye and tell you I have  
17 never changed on this position in all the  
18 years I practiced before the Board. Or even  
19 going back to the time I studied this subject  
20 in law school.

21 For the investor owned electric  
22 utility community and the others that I have

1 represented, we have always argued for book  
2 values. We sat out that case that I just  
3 referred to and other shipper groups supported  
4 the Board's use of the lower values, the time.

5 And the D.C. Circuit, by the way,  
6 didn't hold that the lower values were  
7 required. They simply deferred to the Board  
8 on it's treatment there.

9 But you are quite right that there  
10 have been customers that at times have  
11 supported whatever was the lower value. But  
12 most shippers have not.

13 Most shippers have been consistent,  
14 supported book value all the way through.  
15 Certainly the regulated shippers have. I've  
16 spoken for many of them over and over again.

17 I did it in the revenue adequacy  
18 proceedings. I did it in ex parte 679 and  
19 this issue came up when the railroads argued  
20 for replacement costs, and you rejected that.

21 I have been consistent, my clients,  
22 much more importantly to me, have been

1 consistent on this for over 30 years. We've  
2 advocated for book value just as we do today.  
3 And no premiums.

4 MR. CUTLER: Mr. Chairman, the only  
5 thing I would add is that it seems to me that  
6 this question of valuation approaches is, if  
7 anything, more central to the exercise of the  
8 jurisdiction of other regulatory agencies that  
9 pervasively regulate industries than to this  
10 one.

11 And it's noteworthy that in every  
12 one of those other commissions and FERC and so  
13 forth, the decision has been not to allow  
14 write ups based on acquisition premiums like  
15 this one.

16 CHAIRMAN ELLIOTT: And back to the,  
17 I guess the changing of positions. I know  
18 that cited in BNSF's brief, I believe, it's  
19 its rebuttal, they refer to a flip there by  
20 some of the shippers, including NIT League,  
21 which seems to me a pretty broad expanse.

22 I mean, NIT League seems to include

1 many of the shippers. So I just, it seems  
2 like it's broader than you're making it out to  
3 be.

4 MR. CUTLER: Remember, a number of  
5 NIT League shippers are not captives.

6 MR. MCBRIDE: A number of them are  
7 not even rail shippers. And you'll find that  
8 the regulated utilities and the other electric  
9 generators are generally not members of NIT  
10 League.

11 So it really doesn't speak for many  
12 of the companies that come before you as  
13 shippers. It does include the chemical  
14 companies that are before you as shippers now.

15 But let me point out that this issue  
16 works both ways. The railroads argued for  
17 book value in *Smyth v. Ames*.

18 The railroads argued for book value  
19 in the case that went to the D.C. Circuit in  
20 1990 and against the reduction in value  
21 because of the lower purchase price that was  
22 paid there.

1           So the answer I tried to explain to  
2       you, Mr. Chairman, is that the shippers, some  
3       shippers and the railroad industry have,  
4       indeed, changed positions over time.

5           But not the electric generators.  
6       They have been consistent. They know  
7       something about regulation.

8           They've lived through, in the  
9       history of Smyth v. Ames to Hope and then the  
10      aftermath of Hope, they understand how book  
11      value works, they understand how use of the  
12      nominal cost of capital includes the  
13      inflation, so you don't put it again in the  
14      asset values.

15          They're perfectly comfortable with  
16      that. They know it's a fair system, as Mr.  
17      Wilson explained about the FPC and FERC.

18          And I think that the regulated  
19      companies, at least, that come before you have  
20      been completely consistent on this for all the  
21      years that I have represented them, and have  
22      observed them in their positions before this

1 Board.

2 CHAIRMAN ELLIOTT: Now, in that same  
3 footnote, they do quote a decision from the  
4 Board, from the ICC at the time, referring to  
5 a regulated industry, an electric company.  
6 Would that be an aberration?

7 MR. MCBRIDE: Who is the they? I'm  
8 sorry, which footnote?

9 CHAIRMAN ELLIOTT: It's Footnote 4  
10 on Page 12 of the reply evidence of BNSF. And  
11 they refer to a utility company from the 1988  
12 revenue adequacy decision that took the  
13 acquisition approach at the time.

14 MR. WHITESIDE: That was the  
15 rebuttal testimony, okay.

16 MR. MCBRIDE: I think they're  
17 correct that Edison Electric argued that the  
18 Board should not keep switching methodologies.

19 And at the time, the Board was using  
20 book values, and we argued for consistency on  
21 that, as I recall.

22 CHAIRMAN ELLIOTT: Okay. Last

1 question along those lines. So we kind of  
2 looked at reasonableness, accuracy, and now I  
3 was thinking to look into fairness.

4 With respect to fairness, you know,  
5 I understand that nothing has changed here.  
6 That Berkshire bought BNSF and they've kept  
7 management in place because they thought the  
8 management was very effective.

9 And that there are some results here  
10 that don't appear to be fair just because that  
11 happened. And I raise this with the prior  
12 panel, so I'll raise it again.

13 I think that you're fighting a  
14 difficult battle with respect to precedent and  
15 statutory language.

16 But if we propose to do something  
17 equitable like an equitable remedy like  
18 phasing in the premium, would that be  
19 something that you would be interested in  
20 exploring?

21 MR. MCBRIDE: No. I don't believe  
22 in it. I think it's unprincipled.

1       Something's better than nothing. But I  
2       believe that the Board should use book values  
3       as I've indicated, and I don't understand what  
4       the logic would be in doing it that way, quite  
5       frankly.

6               Let me just say one more thing about  
7       this footnote, because, you know, memory plays  
8       tricks over time. And the issue at that time,  
9       you may recall, was that the asset values that  
10      were paid for were lower rather than the book  
11      value.

12             And there were some issues about the  
13      particular assets. But the ICC did not hold  
14      at that time that premiums could be included,  
15      and that was not an issue before the Court of  
16      Appeals.

17             What's changed, and you've been  
18      asking about, you know, what's changed over  
19      the last 20 or 30 years.

20             What's changed since the time of  
21      that decision as affirmed by the D.C. Circuit  
22      was starting with Blackstone, CMW, and Mr.

1 Crowley laid out all his transactions and all  
2 the numbers.

3 What's changed is that the railroads  
4 have consolidated and consolidated, and those  
5 proceedings were some of the major  
6 consolidations. Their market power has grown  
7 and grown as a result of those transactions.

8 And suddenly, the financial  
9 community has realized, and the larger  
10 railroads that have acquired the smaller  
11 railroads or equal sized railroads have also  
12 realized that because of the largely  
13 deregulated nature of the industries, this  
14 Board is only too well familiar.

15 That they could assign ever greater  
16 values to these assets because the rents could  
17 be transferred to them, particularly if the  
18 Board would allow the premiums to be passed  
19 through.

20 So what's really changed is two  
21 things. Number one, the consolidations and  
22 the increased market power. Number two

1 leading directly to the fact that the assets  
2 were now worth more than the book values  
3 rather than less.

4 I submit to you that's an entirely  
5 different situation then the case where the  
6 assets may have been worth less, because what  
7 the Supreme Court held on the Market Street  
8 Railway case a year after Hope was that a  
9 regulated entity was not guaranteed the  
10 recovery of its investment in the enterprise.

11 It's only a guaranteed an  
12 opportunity to earn a fair return on the  
13 investment in the enterprise. That's all the  
14 constitution required.

15 But the railroad saw that with the  
16 consolidations and the increased market power  
17 and growth of the economy, and the spectacular  
18 increase in the use of coal, which frankly was  
19 a third factor that fueled the revival,  
20 particularly the Western railroads out of the  
21 Powder River Basin, that this situation was  
22 ripe for the payment of large premiums.

1           If the Board would allow them to be  
2       passed through, even better. If it didn't,  
3       they were still worth the payment of the  
4       premiums. So that's what's changed.

5           You're suddenly now dealing with a  
6       situation where for 20 years we've been  
7       looking at premiums.

8           And the railroads are arguing that  
9       this one case where the Board, the ICC, said  
10      we'll use the lower value because that's what  
11      you paid for it, and the court of appeals  
12      simply deferred to the Board's use of that  
13      accounting methodology as a matter within it's  
14      expertise, not that it was required to do  
15      that, somehow necessarily entitles them to  
16      include any amount of a premium in any  
17      transaction that they pay, even one that you  
18      don't have to approve, as here?

19           I don't think that that's what  
20      happened back then, but that's what's changed  
21      since that time.

22           MR. HURST: If I could just say, you

1 know, from a farmer perspective, the last  
2 number of years we've had railroads going  
3 bankrupt and struggling.

4 And we're also, at the same time,  
5 we're experiencing for decades very low  
6 commodity prices and we understood hard times,  
7 frankly.

8 And we now see, though, that the  
9 railroads obviously can attract capital and  
10 stability. In fact, a lot of us said hey,  
11 that's great.

12 If a company like Berkshire Hathaway  
13 would acquire the BN, that's great. That's a  
14 sign of strength and stability and security.

15 But it's kind of also like if a  
16 wealthy land owner, and they do this out west,  
17 if they were to come in from another part of  
18 the country and buy ground that I was renting,  
19 and pay well over the market price of that  
20 ground.

21 But then say okay, as a renter,  
22 they're my new landlord, you're required to,

1       you know, your rent's going to reflect what I  
2       paid for that ground, that's going to be a  
3       pretty tough situation.

4               That's going to drive me out of  
5       business, basically. But as far as we're  
6       concerned, you know, it's, I think a good sign  
7       that outside investors are investing and  
8       actually paying more than market value for the  
9       railroads. That's okay.

10              But then, you know, don't make us  
11      have to pay for that extra.

12              CHAIRMAN ELLIOTT: Vice Chairman?

13              VICE CHAIRMAN MULVEY: Yes. I have  
14      a couple of small questions. One, Mr.  
15      McBride's point, I believe you referred to  
16      Warren Buffett as the richest man in America?

17              Last time I looked at Forbes, I  
18      think he's number two, but he's close.

19              MR. MCBRIDE: I was saying no, if  
20      the richest man in America comes in here next,  
21      I'm worried about what Mr. Gates might buy.

22              VICE CHAIRMAN MULVEY: Oh, okay.

1       What Gates is going to do. I got you. I  
2       thought you referred to him.

3               This gets to the idea that --

4               CHAIRMAN ELLIOTT: He does play  
5       bridge with Mr. Buffett, you know. They can  
6       talk.

7               VICE CHAIRMAN MULVEY: I know. And  
8       you talked about how they arrived at the  
9       amount of the premium and that this seems to  
10      be a black box.

11              If we had a smoking gun that we  
12      could see that indeed there was an agreement  
13      in order to take advantage of circularity,  
14      which is sometimes charged in the utility  
15      cases, that that's why it is done.

16              But we don't have a smoking gun  
17      here. What do we presume? You suggested that  
18      everyone in America basically assumes that  
19      this was not done at arms length.

20              But we don't have any evidence that,  
21      indeed, there was anything untoward about this  
22      premium and about this decision on Mr.

1       Buffett's part save what I would presume to be  
2       a well thought out decision by him and his  
3       advisors to make this acquisition.

4               So do you want to comment on that?

5               MR. MCBRIDE: Yes, thank you very  
6       much. First of all, I have not ever, I hope,  
7       said this morning or at any other time, that  
8       there was anything untoward here. I'm not  
9       saying that.

10              There's nothing illegal, there's  
11      nothing underhanded. This was a transaction  
12      that Mr. Buffett was freely entitled to engage  
13      in.

14              And the BNSF's Board, as I  
15      understand it, looked at the price, as they  
16      were required to do for shareholders, and  
17      determined that it was a good price for  
18      shareholders. Nothing untoward, okay?

19              When I say that it wasn't arms  
20      length, that doesn't mean there was anything  
21      untoward. What that simply means is, it's  
22      like between a husband and a wife. That's not

1 an arms length transaction. They're in  
2 business together, if you will.

3 And similarly here, Mr. Buffett was  
4 the largest shareholder, I believe. At least  
5 owned more than 20 percent of BNSF at the time  
6 he went to see Mr. Rose.

7 He didn't buy 100 percent of the  
8 shares at that time, he bought the remaining  
9 shares at that time. So by definition, is my  
10 point, it was not an arms length transaction.

11 He's the largest shareholder, the  
12 second richest man in America, and the man who  
13 may have the greatest financial ability in  
14 America coming to see Mr. Rose.

15 I don't think that that, just  
16 objectively, is an arms length transaction.  
17 And we know that happened.

18 And we know it was a very short  
19 conversation from what I've been told by  
20 reporters who were told this directly by those  
21 who were there. That it was 15 minutes and  
22 ten minutes of them were spent talking about

1 automobiles, I think.

2 And the share price took about five  
3 minutes. Mr. Buffett, as I'm led to believe,  
4 this is how he does business.

5 He chooses a price, he does it  
6 intelligently, he know's what's going on. He  
7 knows the railroad's regulated, but only  
8 partially so because he's a shareholder and  
9 he's smart and he already owns Mid-American at  
10 this point, which moves coal on the railroad.

11 He knows, as you well know, he said  
12 that his buy of BNSF was a bet on the future  
13 of America.

14 So we know Mr. Buffett knows a lot  
15 about the railroad industry, how it's  
16 regulated, about the country, about the  
17 economy, about our dependence on railroads.

18 And he goes to see Mr. Rose and he  
19 does what he apparently always does in these  
20 circumstances. He says I'll pay you \$100 a  
21 share. I don't want to argue about it.

22 I'm then told that after that, the

1 BNSF board evaluated it, as I indicated to you  
2 earlier, tried to get a little more out of it,  
3 as any good negotiator would try to do, and  
4 apparently Mr. Buffett said no. And then they  
5 took the offer.

6 That, to me, is as far removed from  
7 an arms length transaction as you could have.  
8 Nothing untoward, it was a fair value to him,  
9 presumably. It was a fair value to the  
10 shareholders.

11 The people that weren't in the room  
12 are the regulated customers. And the other  
13 people that weren't in the room were you. And  
14 they never came to you to approve that  
15 transaction because they didn't have to.

16 Again, there was nothing untoward  
17 about that. This is the first chance we get  
18 and you get to look at that transaction, look  
19 at what was paid, and decide whether it was  
20 fair, accurate and reasonable under the rail  
21 transportation policy.

22 I don't have to prove anything

1        untoward happened. I'm simply suggesting to  
2        you that, you know, nobody who had the  
3        customer's interests in mind was there  
4        determining the appropriate amount of the  
5        premium. That's all.

6                MR. CUTLER: Let me return to the  
7        asymmetry point I made earlier, too. We have  
8        no indication, and in fact to all appearances,  
9        the vulnerability of captive shippers to  
10       acquisition premium write ups was not on  
11       Warren Buffett's mind when he acquired BNSF.

12               That didn't drive this transaction.  
13       And we don't think that if you decided this  
14       case in shippers favor, it would discourage  
15       future acquisitions of other railroads.

16               The railroad industry as a whole has  
17       an extremely bright future for all sorts of  
18       reasons.

19               And the likelihood of the railroad  
20       industry being able to attract capital, even  
21       if the BNSF does not benefit from a write up  
22       as a result of your decision in this

1 proceeding, that doesn't change.

2 On the other hand, there is an  
3 asymmetry in the sense that if the BNSF is  
4 allowed to write up its URCS costs and collect  
5 much of the acquisition premium from captive  
6 shippers who really aren't going to be able to  
7 fight back very hard, that sends a signal of  
8 an entirely different order to anybody who  
9 might be considering a future acquisition of  
10 a similar railroad.

11 Oh boy, other people's money. That  
12 makes this deal even more attractive than we  
13 thought.

14 VICE CHAIRMAN MULVEY: Thank you.

15 CHAIRMAN ELLIOTT: Thank you very  
16 much for coming today, and we really  
17 appreciate you taking that time.

18 MR. MCBRIDE: Thank you very much.

19 CHAIRMAN ELLIOTT: We'll call the  
20 next panel up.

21 VICE CHAIRMAN MULVEY: Is there  
22 anybody left running the railroad? Are we

1 short one card there? You're free to edit the  
2 cards, obviously.

3 Do you have any particular order you  
4 want to go in?

5 MR. HUND: I think we're in it.

6 VICE CHAIRMAN MULVEY: Okay, then.  
7 The chairman will be back in a second, but we  
8 can begin now. Thank you. You can start.

9 MR. HUND: You would like us to  
10 start?

11 VICE CHAIRMAN MULVEY: Yes.

12 MR. HUND: Okay, great. Well good  
13 morning. I'm Tom Hund, Chief Financial  
14 Officer of BNSF Railway, and I've been with  
15 the company for 29 years, all on the financial  
16 side. I've been CFO since 1999, and prior to  
17 becoming CFO I was Controller of BNSF Railway  
18 and Sante Fe Railway for a decade.

19 And prior to that I worked for a big  
20 four public accounting firm. And by the way,  
21 it was not the one we engaged to help us with  
22 the evaluation work. I'm also a CPA. And I'm

1       pleased to appear before the Board to discuss  
2       with you the appropriateness and application  
3       of purchase accounting under generally  
4       accepted accounting principles or GAAP, in  
5       this transaction that resulted from Berkshire  
6       Hathaway's acquisition of BNSF.

7               And so the Board scheduled this  
8       hearing to review the issues related to the  
9       treatment and the Uniform Rail Costing System  
10      or URCS and the revenue adequacy determination  
11      of BNSF's 2010 acquisition by Berkshire  
12      Hathaway. As the Board is aware, it's well  
13      stated, well settled that in every acquisition  
14      of a railroad by another entity over the past  
15      20 plus years, the Board and the ICC before it  
16      have required that URCS reflect the post  
17      acquisition cost of the acquired railroad.

18             A few shippers have petitioned the  
19      Board to alter this longstanding adherence to  
20      GAAP accounting rules and the Interstate  
21      Commerce Commission's Act mandate to use the  
22      most accurate financial information available,

1       because those shippers believe they can gain  
2       a modest regulatory advantage. BNSF disagrees  
3       that any change is necessary, and we will  
4       present compelling reasons for the Board to  
5       reject any change to this longstanding  
6       approach.

7               First, I'll be describing the method  
8       and results of the application of GAAP  
9       purchase accounting to this transaction and  
10      how the transaction has not changed the manner  
11      in which BNSF sets our market-based  
12      transportation rates. And I'm joined on this  
13      panel by my colleague, Mr. Weicher, who will  
14      describe in more detail the minimal impact  
15      that purchase accounting may have on the  
16      Board's regulatory functions and on BNSF's  
17      rate prescriptions.

18             Then Mr. Jenkins will outline how  
19      the Board and the ICC have consistently  
20      applied acquisition cost in every major merger  
21      or acquisition transaction in the last two  
22      decades. Professor Weil will discuss how fair

1 value determined by GAAP is superior to out of  
2 date predecessor cost and how the agency's  
3 goal should be practicable application of  
4 economically accurate costs.

5 And finally, Dr. Neels will address  
6 how shipper concerns regarding the use of  
7 purchase accounting in the regulation of other  
8 industries by different agencies do not apply  
9 here. I'll then conclude. Now additionally,  
10 Mr. Baranowski, of FTI is here to answer any  
11 questions related to his prior submitted  
12 testimony.

13 So while much has been argued in  
14 this case, there are several things shipper  
15 groups and BNSF agree on, or at least no one  
16 has objected to and I've outlined them here.  
17 First, no one has disputed that generally  
18 accepted accounting principles or GAAP as set  
19 and enforced the SEC and the Financial  
20 Accounting Standards Board, provide the  
21 foundation for consistent financial reporting  
22 in the United States and that publically

1       traded and other regulated companies such as  
2       BNSF are required to report their financial  
3       information applying these principles.

4               Additionally, we all agree that  
5       purchase accounting, which is basically  
6       adjusting the historic book value of an  
7       acquired entity's assets and liabilities to  
8       the purchase price paid for that entity, is  
9       required by GAAP. And that BNSF Railway and  
10      Berkshire Hathaway appropriately applied and  
11      followed GAAP in this transaction.

12              Purchase accounting is also part of  
13      the well-established standards and regulations  
14      of the STB, which is why our application of  
15      purchase accounting in this transaction is no  
16      different from what's been done in all other  
17      major rail transactions. And in fact the  
18      Board, the ICC, the Railroad Accounting  
19      Principles Board and the courts have  
20      repeatedly reaffirmed over more than two  
21      decades, that purchase accounting is  
22      appropriate.

1           Now let's look at a few other key  
2 points. Some parties to this proceeding would  
3 have you believe that historic book value  
4 represents the sum of original purchase prices  
5 paid for each asset. It does not.

6           Historic book value is an  
7 accumulation of asset values acquired over  
8 many years and by many different transactions.  
9 Some of these assets, like locomotives, we did  
10 purchase. We built others, like track and  
11 bridges, and many others were the results of  
12 prior mergers and acquisitions of entire  
13 companies.

14           Our company is over 150 years old  
15 and the result of several hundred mergers and  
16 acquisitions. And purchase accounting  
17 provides the most economically accurate  
18 measure of our assets and liabilities.

19           Now two additional points are  
20 important to keep in mind. And they are that  
21 two thirds of the write up, meaning the amount  
22 Berkshire paid for which, for BNSF in excess

1 of our historic book value was recorded to  
2 good will, which does not impact the  
3 regulatory cost. And that 100 percent of the  
4 premium, and the premium here I mean as the  
5 amount that Berkshire paid over the market  
6 value of BNSF stock, went to good will. And  
7 I'm going to give specific details on this in  
8 a moment.

9 But first let me briefly review the  
10 process we went through to calculate the  
11 purchase accounting adjustments. The process  
12 started with determining the fair value of our  
13 assets and liabilities. And because we didn't  
14 have the necessary expertise in the various  
15 valuation techniques, Berkshire Hathaway hired  
16 Ernst & Young, a big four accounting firm, to  
17 assist us. And note that I said assist.

18 And at the end of the day, myself,  
19 Matt Rose, Mark Hamburg the CFO of Berkshire  
20 Hathaway and Warren Buffett its Chairman, had  
21 to sign our 10K's as to the appropriateness of  
22 our financial statements. And those financial

1 statements included purchase accounting. So  
2 clearly this is an assist, not a complete  
3 determination.

4 And also we've discussed the, I'll  
5 say, our methodology of purchase accounting  
6 with the STB's accounting staff and I'm not  
7 aware of any unanswered questions from your  
8 staff at this point. And then finally, as  
9 part of the audit at year end, our financial  
10 statements are audited by Deloitte & Touche  
11 and they also agreed with the application of  
12 purchase accounting.

13 Now Ernst & Young's activities  
14 included reviewing the physical condition of  
15 hard assets and looking for synergistic  
16 opportunities with regard to the overall  
17 network of assets. And as I just mentioned,  
18 since our railroad dates back more than 150  
19 years and is the result of many mergers and  
20 acquisitions, the assemblage of our network  
21 contains some amount of duplicative routes.

22 In the evaluation process we

1       assessed an optimized network where only the  
2       productive capacity of the railroad was  
3       considered in establishing the new net book  
4       value for the property, plant and equipment.  
5       This resulted in not only the write up of some  
6       assets, but also the write down of some assets  
7       that are and including assigning no value to  
8       more than 6,600 route miles which represents  
9       about 30 percent of our network.

10               It's also important to note that  
11       this assessment was conducted as of the  
12       transaction closing date, which was February  
13       12, 2010, which was a low point in the  
14       economic cycle, which further reduced the  
15       amount written to hard assets. And as an  
16       example, some locomotives were written down  
17       because they were determined to be excessive  
18       on the acquisition date, but that might not be  
19       the case today.

20               Let's take a look at the numbers for  
21       a moment. Let's look at purchase accounting  
22       at a high level and what impacts regulatory

1 cost and what does not. Here you see that  
2 Berkshire Hathaway paid a total of \$35 billion  
3 for BNSF. Our historic net book value, which  
4 is a historic value of assets less liabilities  
5 on the acquisition date, was \$13 billion.

6 In applying purchase accounting,  
7 this left \$22 billion of the acquisition  
8 purchase price to be allocated to the fair  
9 value of our assets and liabilities with any  
10 excess recorded to an intangible asset called  
11 good will. In this transaction as a result of  
12 the thorough evaluation I just described, only  
13 \$8 billion of the purchase price in excess of  
14 book value was allocated to BNSF's net assets  
15 and \$14 billion was recorded to good will.

16 And there is agreement that this  
17 significant portion of the purchase price does  
18 not impact the regulatory process. And the  
19 \$14 billion is larger in both terms of dollar  
20 and percentage than amounts recorded to good  
21 will in all other railroad transactions.

22 I'm now going to dive a little

1 deeper into the numbers. And for those of you  
2 who perhaps aren't into the numbers as much as  
3 the CFO, I'm also going to summarize the  
4 points at the end because the next couple  
5 slides get a little mathematical.

6 We're going to walk through the  
7 purchase accounting step by step using some of  
8 the same numbers I just used, but compare it  
9 to the historic book value and to the market  
10 value just before the Berkshire acquisition  
11 was announced and to what Berkshire paid. So  
12 let's start with BNSF's historic book value  
13 was \$13 billion, or \$38 per share.

14 Well the market value immediately  
15 prior to the announcement of the acquisition  
16 was \$26 billion or \$76 a share. So this  
17 represents a market premium over historic book  
18 value of BNSF of \$13 billion. So said in  
19 another way, said simply, before the Berkshire  
20 deal was announced, the free market said that  
21 BNSF was worth about twice its historic book  
22 value.

1           Now Berkshire paid over \$100 per  
2           share, \$35 billion, which was about a 31  
3           percent premium. And that premium in the  
4           aggregate was about 22 billion over historic  
5           book value and 9 billion over total market  
6           value of BNSF immediately prior to the  
7           purchase announcement.

8           Let's talk briefly about that \$100  
9           per share and Mr. McBride's comments. First  
10          of all, two investment bankers issued fairness  
11          opinions to the BNSF Board and all of that's  
12          described in our public proxy statement.

13          But secondly, and I believe more  
14          importantly, 95 percent, I'm sorry over 95  
15          percent, I think the number was 98 percent of  
16          all shareholders who voted on the transaction  
17          of whether they should accept the \$100 or not,  
18          voted to accept the \$100. So we had almost  
19          unanimous agreement of our shareholder base  
20          and not just our Board of Directors, that this  
21          was an appropriate value for the company.

22          Only 8 billion of the 22 billion

1 total premium over historic book value was  
2 allocated to the assets and liabilities that  
3 impacted regulatory costs while the remaining  
4 14 billion was attributed to good will. And  
5 Berkshire paid 9 billion more than the market  
6 value of BNSF. So you can see that 5 billion  
7 of good will was already implied in BNSF's  
8 market value prior to the Berkshire purchase.

9 So the purchase price paid for the  
10 railroad was driven by market, but the 8  
11 billion in added net asset value was  
12 determined by a different method. And that  
13 method was the thorough evaluation process  
14 required by GAAP and performed with the  
15 assistance of Ernst & Young that I described  
16 earlier.

17 Let's talk about the split between  
18 good will and other assets and why that  
19 matters. Good will is an intangible asset  
20 that doesn't affect URCS regulatory cost. As  
21 I just demonstrated, the portion of the write  
22 up went to net assets and reflected in URCS in

1 revenue adequacy determinations was already  
2 reflected in our stock price prior to the  
3 acquisition. Every dollar of the premium  
4 Berkshire paid over the market value of stock  
5 went directly to good will, which again has no  
6 impact on the regulatory framework.

7 Now some would have you believe that  
8 Berkshire paid a significant premium in hopes  
9 of recouping that premium through increasing  
10 rates on regulated traffic. Now that's not  
11 correct. Because even if Berkshire had gotten  
12 another offer two weeks after their agreement  
13 with us to sell BNSF for \$150 a share to  
14 another buyer, there would have been no change  
15 to the \$8 billion write up.

16 So all of this shows that Mr.  
17 McBride's accusation that Berkshire  
18 manipulated the system is incorrect. Some  
19 shipper groups also contend that allowing  
20 purchase accounting will give BNSF the ability  
21 to significantly raise rates to its customers.

22 And they contend that if BNSF URCS

1 cost increase because of the application of  
2 purchase accounting, some rates that are now  
3 subject to rate regulation would fall below  
4 the jurisdictional threshold. I do not agree  
5 that rates will increase because of this  
6 transaction. BNSF's policy and practice is to  
7 set rates based on market conditions and  
8 market demands for its services, not cost.

9 A significant portion of BNSF's  
10 rates are not regulated by the Board. BNSF  
11 competes vigorously for this business and as  
12 a result its rail rates must be determined  
13 based upon market forces. BNSF establishes  
14 rates for traffic that is subject to  
15 regulation in the same way, based upon market  
16 conditions, not based upon regulatory cost.

17 Also a small change in the Board's  
18 regulatory cost would not affect the rates we  
19 charge. BNSF does not set rates on our  
20 traffic based on where it falls in relation to  
21 the jurisdictional thresholds. We estimate  
22 that out of 9 million revenue moves in 2010

1 involving thousands of shippers, less than 2  
2 percent of regulated movements would move from  
3 above to below the Board's jurisdictional  
4 thresholds.

5 And using a different bottoms up  
6 approach, Western Coal traffic league's expert  
7 witness statement confirmed that the impact  
8 was limited to less than 2 percent of BNSF's  
9 2010 movements. And for even this handful of  
10 shipments the practical impact of this shift  
11 would be negligible, as few shippers ever  
12 bring a rate case and even fewer are brought  
13 that challenge the rate at or near the  
14 jurisdictional thresholds.

15 And Mr. Weicher is going to go into  
16 more details about the impact of purchase  
17 accounting on rate regulation. But finally,  
18 as evidence to BNSF's market-based pricing,  
19 we've all read recent articles discussing  
20 Class 1 railroad's reaction and impact,  
21 reaction to the impact rather, on coal demand  
22 due to mild winter weather and low natural gas

1 prices. And I can tell you that in certain  
2 circumstances BNSF has reduced coal rates  
3 reflecting these changed market conditions,  
4 including for some solely served utilities.

5 Let me conclude by saying that GAAP  
6 is the gold standard of financial reporting  
7 and is required by the SEC. To make us use a  
8 different method of accounting for STB  
9 purposes would require us to keep two sets of  
10 books. A less onerous solution would be to  
11 deal with the limited instances where rates  
12 may be impacted rather than changing the  
13 reporting standard.

14 Specifically, we do have two unique  
15 situations and those are Western Fuel and  
16 AEPCO, where the Board prescribed a rate at  
17 the end of a stand alone case using R/VC  
18 ratios based upon URCS cost prior to the  
19 Berkshire acquisition. In these unique  
20 situations the purchase accounting adjustment  
21 may alter BNSF's URCS cost for regulatory  
22 purposes and create a modest effect on the

1 rates and those R/VC ratios that they  
2 translate into.

3 These two unique cases have nothing  
4 to do with the rate sets BNSF sets for the  
5 other shippers or for our rates that BNSF will  
6 be able to set for markets for services going  
7 forward. These unique cases can be addressed  
8 in the context of those specific proceedings  
9 which remain open before the Board.

10 So in conclusion, the Board should  
11 not break from over two decades of precedent  
12 and change its policy on the application of  
13 purchase accounting, which is governed by very  
14 specific accounting rules that are universally  
15 accepted in the United States.

16 MR. WEICHER: Good morning. Thank  
17 you Chairman Elliott, Vice Chairman Mulvey and  
18 Commissioner Begeman for the opportunity to  
19 appear. My name is Rick Weicher, Vice  
20 President and General Counsel Regulatory of  
21 BNSF Railway. I've been with the company for  
22 over 35 years as a member of the legal

1 department. I've worked extensively in the  
2 areas of regulatory practice transactions and  
3 administrative litigation before the Surface  
4 Transportation Board and its predecessor  
5 agency.

6 I appreciate the opportunity to  
7 address these issues arising from the  
8 Berkshire acquisition of BNSF. I will  
9 describe the effects of the accounting  
10 treatment Tom Hund has reviewed in several  
11 areas of STB specific regulation. The Board's  
12 methodologies in rate cases that come before  
13 it, regulatory costing under URCS and in  
14 connection with existing prescriptions and  
15 then the area of revenue adequacy.

16 And overall why the application of  
17 GAAP purchase accounting has a minimal to  
18 limited impact on the access to remedies  
19 before this agency and their application by  
20 this agency. First in the Board's rate  
21 remedies and rate procedures I'll address the  
22 stand alone cost major rate case. It's

1 constrained market pricing approach.

2 I should say I think there is a  
3 theme in the Board's regulatory methodologies  
4 adopted in the last few years, which does  
5 involve revenue varied costs, R/VCs. But it  
6 compares them as part of its standards in all  
7 sizes of rate cases. And I think that's an  
8 important distinction.

9 Okay. Stand alone cost major rate  
10 cases, we've heard from coal shipper  
11 organizations this morning. I think the first  
12 determination that is made by the Board in a  
13 stand alone rate case, is whether stand alone  
14 revenues of the hypothetical stand alone  
15 railroad, the highly litigated hypothetical  
16 stand alone railroad, exceeds stand alone  
17 costs.

18 But those aren't based on URCS.  
19 They are based on the cost developed for this  
20 hypothetical current stand alone railroad that  
21 the shipper hypothesizes. If that threshold  
22 is crossed, then ultimately under the Maximum

1 Markup Methodology, the MMM, the regulator,  
2 the Board as the regulator compares relative  
3 revenue to variable cost ratios to set a  
4 maximum reasonable rate.

5 All those relative revenue to  
6 variable cost ratios at that point, I'm  
7 talking about any case from today on,  
8 incorporate the purchase accounting adjustment  
9 in the asset base and it won't matter. Now  
10 you can try to hypothesize extreme  
11 circumstances exactly the precise effect in  
12 case.

13 But basically the base changes for  
14 all of them and as some of the discussion  
15 before was, it doesn't make any real  
16 difference from then on. It's not a question  
17 of something happening later to a base. The  
18 base started out with the comparable purchase  
19 accounting in the URCS for all of them driving  
20 that methodology.

21 I don't want to go into the weeds of  
22 this. But it also would be the case for the

1 costs used in the ATC allocations. If they're  
2 using URCS costs in those for the crossover  
3 revenues, they're still using the same kind of  
4 thing on both sides of divides where they do  
5 something.

6 So we really believe that analysis  
7 shows that for stand alone major rate cases  
8 under this Board's constrained market pricing  
9 its new way, from here on it doesn't alter the  
10 ultimate outcome. We'll come back to the  
11 jurisdictional threshold. Obviously that  
12 applies to all cases. I'm talking about this  
13 methodology.

14 Similarly, if we go to simplified  
15 SAC cases there shouldn't be any affect, or  
16 any meaningful effect. They are driven off of  
17 SAC, they are driven off of stand alone costs.  
18 Some of our own stand alone rate cases end up  
19 being in the SAC cases and they're still all  
20 based on a common denominator of  
21 comparability.

22 Actually, while operating expenses

1 are used in the simplified case that use URCS  
2 costs, these effects should at most be mixed.  
3 The roadway portion is not really used and for  
4 BNSF equipment was written down in the  
5 adjustment we're talking about, which could  
6 benefit the shipper.

7 But in any event, these are cases  
8 with a fixed set of perimeters and we've never  
9 had a simplified SAC case filed against BNSF.  
10 Then if we go to the three benchmarked small,  
11 and we should emphasize the word small rate  
12 case here, these standards the Board adopted  
13 are also largely driven by comparable R/VCs,  
14 by relative R/VCs of the chosen comparison  
15 group.

16 The issue that is intensely  
17 litigated is the comparison group. But the  
18 comparison group and the complaining traffic  
19 are compared based on R/VCs that would be  
20 based on the same costing base.

21 The RSAM does come into play, the  
22 Revenue Shortfall Allocation Method does have

1 an impact. It's not entirely clear and you  
2 have all these moving pieces, how much of an  
3 impact or where it would be. It could go up.  
4 It could go down. But this is on the margin.  
5 This is an adjustment to something that has  
6 been determined by the comparability group  
7 R/VC comparison that the Board uses to drive  
8 the rate.

9 But finally, these are small cases.  
10 And the recovery is limited as been referred  
11 to earlier the \$1 million threshold for  
12 reparations and relief. So if something is  
13 going on here it's going to affect, as much as  
14 anything, the timing of that 1 million,  
15 whether it's stretched out or more compressed.  
16 But some of the hyperbole we heard earlier  
17 today we think is fundamentally wrong as, in  
18 terms of what drives this methodology.

19 Then we can go to the jurisdictional  
20 threshold. The shippers have made much of the  
21 fact that as a result of purchase accounting  
22 some rates that are above the jurisdictional

1 threshold may fall below it, theoretically  
2 depriving shippers of their right to rate  
3 reasonableness review. We think this is a red  
4 herring.

5 As Tom Hund has stated and our  
6 evidence of our Marketing Officer, John  
7 Lannigan stated, BNSF sets its rates based on  
8 market factors not where the jurisdictional  
9 threshold falls. Leaving aside some of the  
10 assertions Mr. McBride earlier made that Mr.  
11 Hund referred to when Mr. McBride makes these  
12 breezy, incredible, unfounded assertions of  
13 manipulation, which are just ridiculous on  
14 their face.

15 Leaving that aside, if we take his  
16 comments about rate making, as we've testified  
17 and happens in the real world, BNSF Railway  
18 rates are based on market forces, not  
19 regulatory costs. But that's not just for  
20 exempt rates. That's also for regulated  
21 rates. And it's a very important factor.

22 On the threshold, I've practiced in

1       this area for a very long time, pre- and post-  
2       Staggers, it's hard to picture or imagine what  
3       cases are brought at the margin of the  
4       jurisdictional threshold. That is a statutory  
5       concept. It's a safety net.

6               But as our evidence has shown, as  
7       Mr. Baranowski put in his written testimony  
8       and I don't think this is much different than  
9       Mr. Crowley's testimony, the average impact on  
10      URCS costs from this adjustment is about 5  
11      percent. And that probably projects to  
12      somewhere in the 7 or 8 percent on an R/VC  
13      ratio, I mean you're doing a mark up there.

14             And the number of regulated  
15      shipments who would transition from above or  
16      to below the jurisdictional threshold as a  
17      result of this is accordingly minimal. And  
18      they'd be regulated shipments. And it'd be  
19      less than 2 percent of our shipments in 2010.  
20      Again it's very hard to picture why this would  
21      be a decisional factor or what shippers around  
22      the edge are bringing a case based on this

1       minimal impact.

2               All rate cases, of course, are  
3       affected by this jurisdictional threshold.  
4       But this is a safety net, driven by statute.  
5       And if a case is brought that challenges a  
6       truly unreasonable rate, presumably it's high  
7       enough that it shouldn't matter and the  
8       jurisdictional threshold isn't involved and  
9       the threshold never comes into play.

10              Even Mr. Crowley cited how few rates  
11       are close to that threshold and if something  
12       is that close the impact should be negligible,  
13       excuse me, on the impact and availability of  
14       shipper revenues, remedies or why someone  
15       should bring a case. But from a policy  
16       standpoint, if in a given case the rail world  
17       is driven down to the statutory jurisdictional  
18       threshold, it should be based on the most  
19       accurate costs.

20              Overall, the impact on existing  
21       regulatory remedies is minimal. But even if  
22       you have a small impact on the margin from

1 using more accurate costs, there is nothing  
2 wrong or unfair with that. And the contrary  
3 would be wrong.

4 There's no valid reason with respect  
5 to future cases to not adopt purchase  
6 accounting in determining URCS for rate cases  
7 and even for the three benchmark method after  
8 another year or two. And all relevant data  
9 reflects this adjustment.

10 We should talk and we will about the  
11 existing prescriptions. They keep coming up,  
12 the cases that straddle this transaction. If  
13 the Board has a concern with the unanticipated  
14 consequences today of the Board's transition  
15 some years ago to R/VC, Revenue Variable Cost  
16 based maximum rate prescriptions, as opposed  
17 to the nominal dollar prescriptions that were  
18 indexed in a formula that didn't use the R/VC  
19 formula, were just dollars and cents with  
20 respect to the two stand alone cost coal rate  
21 cases that pre date or straddle this  
22 transaction, such as Western Fuels or AEPCO,

1       they can be addressed.

2               Now AEPCO involves the  
3       jurisdictional threshold. Not even a known  
4       maximum markup. I have trouble with that MMM.  
5       But I thought I should say it all the way  
6       through because it's your methodology. But  
7       the MMM methodology, we don't know what the  
8       prescription is there. The Board directed it  
9       would be below. Okay fine.

10              But so, the principle is the same  
11       with respect to that MMM prescription I think  
12       the issue of jurisdictional threshold is  
13       somewhat different. But if the Board is  
14       concerned with that straddle treatment of  
15       Western Fuels the Board could easily adopt a  
16       bridging mechanism to retain the original  
17       intent of its finding in those cases.

18              This could readily be done by a one  
19       time linking factor to adjust the R/VCs in  
20       those cases that could carry forward for those  
21       existing prescriptions. One of them is  
22       already open before you. The other is on

1 appeal. But they're readily addressable by  
2 this Board within its authority without  
3 affecting fundamental principles of GAAP  
4 accounting and the right thing to do.

5 In reality the difference between  
6 the URCS with or without purchase accounting  
7 is on average about 5 percent. The actual  
8 application in a straddle case, if it's of  
9 concern could be addressed in that case  
10 without rejecting established precedent and  
11 this doesn't matter at all for any prior  
12 prescriptions that are in dollars and cents.  
13 Nothing changed under the Board's prior  
14 orders.

15 I don't, finally, revenue adequacy.  
16 The other topic that keeps coming up is what  
17 is the impact on revenue adequacy and revenue  
18 adequacy future standards and determinations.  
19 In 2010, BNSF remained revenue inadequate  
20 independent of the incorporation of the  
21 purchase accounting adjustments.

22 In fact, BNSF was found to earn the

1 cost of capital in only one year in the past  
2 decade, 2006. Indeed only once since BNSF was  
3 formed in 1995. We have never been found to  
4 earn the cost of capital over any sustained  
5 period of time and thus revenue adequate.

6 The future cost of capital and  
7 future cost of capital determinations for  
8 companies, revenue adequacy determinations for  
9 a company will be affected by the future cost  
10 of capital, the economy and company  
11 performance. Those things will determine  
12 whether we're revenue adequate or inadequate  
13 in the future.

14 This will have some impact on the  
15 numbers. But we then ask ourselves what are  
16 the future standards in a revenue adequate  
17 world, that one should be concerned with if  
18 one should be concerned? Even if BNSF were to  
19 be determined revenue inadequate in a given  
20 year where the accounting treatment would have  
21 changed the result, there's no reason to  
22 assume a shipper would be denied access to

1       some kind of remedy.

2               On the contrary, as we've just  
3       discussed, the impact of the accounting  
4       adjustment on the availability of existing  
5       rate remedies for a revenue inadequate carrier  
6       is zero to minimal. The Board has not yet  
7       determined under what conditions or for how  
8       many years a carrier being revenue adequate  
9       should trigger or mean different regulatory  
10      standards should apply.

11             Nor has the Board yet established  
12      how and to what extent different regulatory  
13      remedies should be made available for a  
14      shipper to challenge a rate of a revenue  
15      adequate carrier. This is talked about a lot  
16      before this Board and otherwise. It'll happen  
17      in due course, if that's the situation the  
18      industry and the Board'll see.

19             But in the absence of those  
20      determinations, there is no reason to assume  
21      any adverse impact upon shippers. If and when  
22      future standards are adopted for revenue

1       adequate carriers, we should more reasonably  
2       assume that the Board would then reflect the  
3       current accounting standards across the board  
4       that is has in place and determine how its  
5       remedies should apply in that situation.

6               Current precedent, very well  
7       established and proper GAAP accounting  
8       standards should not be distorted now or  
9       disregarded in this instance for yet  
10      undetermined regulatory standards. Thank you.

11             MR. JENKINS: Good morning or good  
12      afternoon. I'm Rob Jenkins a partner at Mayer  
13      Brown, LLP. My practice focuses on STB rail  
14      regulation and deregulation and I have  
15      considerable experience with the issues before  
16      you today. I can't claim to be a contemporary  
17      of Grover Cleveland's, but I have been doing  
18      this at least as long as Mr. McBride.

19             The shippers bear a very heavy  
20      burden here. They have to show why the STB  
21      should reverse 25 years of settled policy and  
22      law using GAAP purchase accounting for revenue

1 adequacy and URCS costing purposes and apply  
2 different regulatory standards to BNSF than to  
3 anyone else.

4           They have not done that and they  
5 cannot do it. Acquisition cost is required by  
6 the Board's rules and the ICC and the STB have  
7 consistently applied acquisition cost in every  
8 merger or acquisition transaction since the  
9 RAPB recommended its adoption. Nothing about  
10 the BNSF Berkshire transaction distinguishes  
11 it in any relevant way from every other  
12 transaction where GAAP purchase accounting has  
13 been applied.

14           Let's look at the prior  
15 transactions. The first thing you'll see here  
16 is that in percentage terms the purchase  
17 accounting adjustments for the BNSF Berkshire  
18 transaction were less than for almost all of  
19 the prior transactions. That means that the  
20 impact on BNSF's regulatory costs is  
21 relatively smaller than in those earlier  
22 transactions.

1           Mr. McBride repeated several times a  
2       nightmare scenario where the amount of the  
3       acquisition premium was burgeoning,  
4       transaction by transaction, when in fact what  
5       drives increases in URCS variable costs is the  
6       percentage increase in the rate base. It's  
7       not the dollar amount.

8           So all of this talk about billions  
9       of dollars of increases in acquisition  
10      premiums is irrelevant. It's the percentage  
11      increase that matters and here the increase  
12      was, as Mr. Weicher has said, about 5 percent.

13          It bears emphasizing as well as the  
14      last column shows that in the Berkshire  
15      transaction more than 14 billion was allocated  
16      to good will. That's two-thirds of the write  
17      up and it has no impact on the regulatory  
18      costs. No other railroad merger or  
19      acquisition had any appreciable amount  
20      allocated to good will.

21          Thus, from a regulatory standpoint  
22      the effect of the BNSF Berkshire merger on the

1 railroad's costs is less than in most prior  
2 transactions. All of these transactions were  
3 approved. All of the prior transactions were  
4 approved by the ICC or the STB and acquisition  
5 cost was used to value the railroad's costs  
6 for revenue adequacy and URCS costing  
7 purposes.

8 Now Mr. Crowley and some of the  
9 other witnesses here today claim that the  
10 other merger and acquisition transactions are  
11 distinguishable because they involved merger  
12 synergies. You can see from the chart, and  
13 Chairman Elliott had a colloquy with Mr.  
14 Crowley about this earlier, that one of the  
15 prior transactions was the acquisition of CNW  
16 by Blackstone, which is an asset management  
17 and financial services company.

18 No one claimed there that  
19 acquisition costs should not be used because  
20 there were no merger synergies. And the cost  
21 benefits that they cited to were basically the  
22 result of operating plants. There was no tie

1       into acquisition costs.

2               If they had, the other thing is that  
3       in none of the other transactions, save one,  
4       the Conrail case which we'll discuss in a  
5       minute, was there any discussion about  
6       acquisition cost. Mr. Crowley suggested that  
7       somehow shippers had, through a tradeoff  
8       between merger synergies and acquisition  
9       costs.

10              That's simply not the case. There  
11       was no discussion at all about the acquisition  
12       premium. It was applied as a matter of  
13       course, because that was what the Board's  
14       rules required and that was what their  
15       precedent required.

16              If they had claimed that acquisition  
17       premiums should not be permitted, they would  
18       have lost. Because the RAPB and the ICC and  
19       the STB did not require the use of acquisition  
20       costs because of merger synergies. They  
21       required it for economic accuracy and to  
22       comply with the statute.

1           Two federal circuit courts of  
2       appeals have affirmed the ICC's and the STB's  
3       decisions for the same reasons. Now the one  
4       case that has talked about merger synergies in  
5       connection with the acquisition premium is the  
6       Conrail NS CSX case. And let me stop right  
7       there and note that there were clearly merger  
8       synergies in that case, but that didn't stop  
9       the shippers from attacking the use of  
10      acquisition costs there.

11           They attacked it with merger  
12      synergies and the STB did note that there were  
13      merger synergies, but the foundation of the  
14      STB's decisions in the Conrail case, decision  
15      in the Conrail case, were economic accuracy,  
16      its own rules, the statute and established  
17      precedent. Here's specifically what the STB  
18      said.

19           The Board here emphasized, this is  
20      in the Conrail case, that its rules and prior  
21      precedent require the uniform application of  
22      acquisition costs for revenue adequacy and

1 jurisdictional threshold calculations. I'd  
2 particularly like to draw your attention to  
3 the last sentence of this holding.

4 Mr. LeSeur and Mr. McBride have  
5 suggested that the acquisition premium is  
6 supported by BNSF and was adopted by the RAPB  
7 because it was an accounting rule. Well  
8 that's not why it was adopted. It was adopted  
9 because it was the most economically accurate  
10 measure of costs that the Board has available.

11 The RAPB endorsed acquisition cost  
12 primarily, and this is a quote, "because it  
13 better represents the economic conditions  
14 facing the enterprise than does predecessor  
15 cost." And the ICC in turn determined that it  
16 did not matter whether the acquisition cost  
17 was above or below book value. The use of  
18 acquisition cost was necessary to accurately  
19 measure the real value of a railroad's assets  
20 at the time of the acquisition.

21 And the ICC's position, which the  
22 shippers supported, was affirmed by the DC

1 Circuit. Now, let me go back to the shipper  
2 support point. Mr. McBride says memory can  
3 play tricks on you. And apparently it played  
4 a big trick on him here because he said that  
5 electric utilities always took the position  
6 that the Board should use predecessor cost.

7 That's not true. I took part in  
8 both the RAPB proceedings and in the Conrail  
9 proceedings and in the appeal to the DC  
10 Circuit, but I'm not relying on my memory  
11 here. If you look at the ICC's decision that  
12 was appealed to the DC Circuit and this is at  
13 6 ICC 2nd 933 and the cite to the particular  
14 page is to 939.

15 It says EEI, that's the Edison  
16 Electric Institute, that's the association of  
17 the electric utilities. EEI also supports the  
18 use of acquisition cost. EEI argues that we  
19 should not switch methodologies simply because  
20 they happen to affect revenue adequacy  
21 determinations. One method should be adopted  
22 and used regardless of the results.

1           That was the EEI speaking. It also  
2 notes that the National Industrial  
3 Transportation League took the same position.  
4 While I'm on, looking at this case I should  
5 also answer another point that Mr. McBride  
6 made, which was he said that the only issue in  
7 the ICC case was sales of railroads below book  
8 value.

9           In fact, the ICC in this proceeding,  
10 this the revenue adequacy 1988 proceeding,  
11 specifically addressed adopting a uniform  
12 position that it would apply regardless of  
13 whether the railroad was purchased for a price  
14 below or above book value. And they said it  
15 about that in particular with respect to sales  
16 above book value.

17           If we understate the value of  
18 railroad assets in applying the costs of  
19 capital standard, the revenue requirements of  
20 the railroads will be understated relative to  
21 the investors expected rate of return. They  
22 also said that on using book value, when the

1 railroad was acquired for more, using  
2 acquisition cost, no using book value, when  
3 the railroad was required for more than book  
4 value, would potentially shortchange those  
5 recent investors who have been paid a premium  
6 above the old book value with a return below  
7 the cost of capital for their investment.

8 So, that brings me back then to the  
9 decision in Conrail because Mr. McBride also  
10 talked about the statute. And here is what  
11 the Board had to say about the statute, the  
12 statutory foundation of its rules from a  
13 costing standpoint and here is what the Board  
14 had to say with respect to the, let's see, is  
15 this the costing? No, this is, yes is with  
16 respect to revenue adequacy.

17 So they had a statutory foundation  
18 for both their costing and their revenue  
19 adequacy determinations. I should also point  
20 out that in the Conrail decision, the STB  
21 rejected the analog to other regulatory, other  
22 regulated industries.

1           In every single proceeding where  
2       this has come up the shippers have raised,  
3       someone has raised the question of an analogy  
4       of different treatment in other regulated  
5       industries. And the ICC, the STB and both  
6       Courts of Appeals have expressed they rejected  
7       those analogies.

8           You know, these findings and  
9       conclusions of the STB are just as applicable  
10      to the BNSF Berkshire transaction as they were  
11      to the Conrail CSX/NS transaction and the  
12      other transactions that proceeded it. None of  
13      these conclusions was based on merger  
14      synergies.

15          You know, the 2nd Circuit also  
16      affirmed the STB's decision without any  
17      reliance on merger synergies. There was  
18      discussion earlier about the fact that the 2nd  
19      Circuit was moved by the fact that there were  
20      merger synergies.

21          Well that's not exactly what the 2nd  
22      Circuit said. What the 2nd Circuit said was

1       that even if no efficiencies were captured by  
2       these transactions, thresholds for rate  
3       regulation would only rise 7.26 percent for NS  
4       and 4.9 percent for CSX.

5               As we've discussed, it rises about 5  
6       percent for BNSF. So if you're concerned  
7       about the amount of the increase it's well  
8       within what the 2nd Circuit thought was  
9       reasonable for the STB to affirm.

10              I should also point out that two  
11       years later in the major railroad  
12       consolidation procedures rule making, the STB  
13       held again and I quote, "there is no sound  
14       economic justification for using predecessor  
15       cost rather than acquisition cost to value an  
16       acquired railroad's assets." And again, there  
17       was no reference to merger synergies.

18              So the economic and legal foundation  
19       of the Board's rules are clear. And the  
20       Board's application of those rules has been  
21       consistent. Mr. LeSeur and Mr. Crowley and  
22       other people have talked about unfairness and

1       they claim that it is unfair or inequitable  
2       for the Board to apply rules that could have  
3       some adverse impact on them. Now Mr. Weicher  
4       has discussed the fact that there are unlikely  
5       to be any significant adverse impacts on the  
6       shippers.

7               But even if there were impacts,  
8       there is nothing unfair about evenhandedly  
9       applying economically accurate costs  
10      regardless of who benefits. What would be  
11      truly unfair and arbitrary would be to  
12      knowingly apply economically inaccurate costs  
13      to favor one party over another.

14             Mr. Crowley has suggested that you  
15      should look at this on a case by case basis.  
16      And it has always been the case that the ICC  
17      and the STB have said that they don't  
18      automatically apply the acquisition premium.

19             If someone can show that the result  
20      of applying the acquisition premium in a  
21      particular case would be skewed because the  
22      investment base was inaccurate, not in

1 conformance with GAAP or was inflated, then on  
2 that basis you could apply something other  
3 than the acquisition premium. But in this  
4 case, there's no challenge to the premium that  
5 is being incorporated in the investment base  
6 here.

7 WCTL has expressly said that they're  
8 not claiming that the acquisition premium was  
9 inflated or not bonafide. So that issue  
10 simply doesn't apply. Finally, let me get to  
11 this question of fair and accurate. Nobody  
12 contends that predecessor cost is more  
13 economically accurate than acquisition cost.  
14 I agree with Mr. McBride that you ought to be  
15 using fair and accurate costs and the most  
16 fair and accurate costs are acquisition costs.

17 So from the standpoint of good  
18 policy and good law that should be the end of  
19 the matter. Shippers have not demonstrated  
20 why Berkshire's acquisition BNSF should be  
21 treated differently than the rail mergers and  
22 acquisitions that came before.

1           The Board has a responsibility to  
2       apply its rules consistently and evenhandedly.  
3       It should treat the BNSF Berkshire transaction  
4       the same as the others and dismiss WCTL's  
5       petition.

6           DR. WEIL:   Ready for me?   I'm Roman  
7       Weil.   I am from the University of Chicago not  
8       from the BNSF Railway Company, so I tried to  
9       scratch this out here.   I've been a scholar  
10      and a professor over 45 years.   I started life  
11      with a PhD in economics, taught economics.   I  
12      still think I'm an economist, think like an  
13      economist.

14           But about 35 years ago I started  
15      doing microeconomics accounting.   I became a  
16      CPA and I've written a dozen textbooks and  
17      professional reference books mostly about  
18      accounting.   The, I think though I'm an  
19      economist who knows something about  
20      accounting.

21           The most important part of my  
22      training in converting from being a professor

1 of economics to one of accounting, was writing  
2 an accounting dictionary. It sensitized me to  
3 the fact that accounting language, the  
4 language of business uses ordinary every day  
5 English words, but uses them in technical ways  
6 and ambiguous ways.

7 Example I use most with my students  
8 is the phrase making money. You all think you  
9 know what making means. It means six  
10 different things in addition to  
11 counterfeiting.

12 The most ambiguous word in the  
13 accounting finance vernacular is the word  
14 capital. It can refer to assets. It can  
15 refer to equities. It could refer to the  
16 entire sum on the left-hand or right-hand side  
17 of the balance sheet or a portion of it. So  
18 the word capital is ambiguous.

19 The worst reserve in all of  
20 accounting is reserve. In this case there are  
21 two words or terms that are ambiguous and as  
22 I sit and listen cause trouble here. Mr. Hund

1 and Mr. Jenkins have talked about those two.

2 The one is the word premium. I  
3 heard some of the other folks saying that this  
4 was not arms length and the premium paid could  
5 have been more or less. All of the premium  
6 that he was talking about, ends up in good  
7 will. It does not affect the regulated rate  
8 base here that we're talking about. That's  
9 the \$8 billion number.

10 The purchase accounting assessments  
11 that were done by accountants and with aid  
12 from outside CPA's. The amount that was maybe  
13 or maybe not at arms length, that ends up in  
14 good will whatever it is, not part of the  
15 regulatory pieces. Mr. Hund said that.

16 The other word or phrase that is  
17 being slung around here, and Mr. Jenkins is  
18 just focused on it is, accurate or  
19 economically accurate. Since I wrote a  
20 dictionary, I know to go back to sources. I  
21 went to the RAPB writings. And I could find  
22 economic accuracy only in one caption, not in

1 a paragraph, but in a heading. And in the  
2 paragraph under that heading it refers to  
3 current economic conditions.

4 So when you talk about accuracy in  
5 this framework, I think you should always use  
6 the two word term, economic accuracy and focus  
7 on current economic conditions. The  
8 accounting expert on the other side and I both  
9 agree that old historic predecessor numbers  
10 are accurate, single word, that is to say if  
11 you look at a bunch of invoices and add up the  
12 numbers you get a number that's accurate.

13 If you look at acquisition costs,  
14 those are accurate. But the issue here is not  
15 accurate in that sense, in the footing and  
16 ticking and auditing sense. It's economically  
17 accurate, current economic conditions.

18 Now I have known since I first  
19 started studying economics that you want to  
20 focus on what economists call opportunity  
21 costs. That's the way people make optimal  
22 decisions. We're here trying to figure out

1       how to allocate society's scarce resources in  
2       order to maximize the wealth of the nation.  
3       And you do that when you focus on opportunity  
4       costs not on old, out of date historic costs.

5               I've been challenging my students  
6       for 30 years to come up with an example of any  
7       decision that any business person has to make  
8       that is better made using old historic costs  
9       rather than current values, other than where  
10       it's decreed by law, like a capital gains  
11       transaction or a property tax valuation or in  
12       a stewardship calculation.

13               But if ever a business person is  
14       facing a decision, that business person wants  
15       to know the current value of something, not  
16       its old outdated historic, your building burns  
17       down and you're offered an insurance  
18       settlement by an insurance company. You don't  
19       want to know what you paid for that building  
20       20 years ago. You want to know what's it  
21       going to cost to replace today, is one  
22       example.

1 I challenge anyone, because I've  
2 been trying this for 30 years, to give me any  
3 example of a business decision that is better  
4 made on historic costs then current costs. So  
5 I'm really here as an economist asking you to  
6 focus on economic accuracy and understand that  
7 means opportunity costs. And you need to  
8 focus on opportunity cost to use assets  
9 productively for the increase of the wealth of  
10 society.

11 In addition to that I can say that  
12 GAAP says use the current purchase cost.  
13 That's been said. It's said again. There's  
14 no dispute about that. The thing I think you  
15 need to do is to focus on the term economic  
16 accuracy and understand that means current  
17 economic conditions. And allocate our  
18 resources using those data, not the old  
19 historic data. I think I'll stop there.

20 DR. NEELS: Thank you. My name is  
21 Kevin Neels. I'm not with the Burlington  
22 Northern Railway either. I'm a principal at

1 the Brattle Group where I lead that firm's  
2 transportation practice. I'm also the  
3 Chairman of the Committee on Freight  
4 Transportation Economics and Regulation of the  
5 Transportation Research Board. I have a PhD  
6 from Cornell and I am an expert in regulatory  
7 economics and in particular STB regulation of  
8 rail markets.

9 I previously submitted written  
10 testimony in this proceeding with my  
11 colleague, Lawrence Colby. BNSF has asked me  
12 to comment here on the reasons why some of the  
13 analogies that witnesses for shippers have  
14 drawn to other regulatory, regulated  
15 industries and regulatory schemes do not apply  
16 to the railroad industry or to the STB's  
17 regulatory policies and procedures.

18 A lot of this, the discussion about  
19 the appropriate treatment of acquisition  
20 premiums has to do with the way in which these  
21 premiums are treated under cost of service  
22 regulation. It is true that some industries

1 are subject to pervasive cost and service  
2 regulation.

3 The firms in these industries charge  
4 regulated prices based on their costs. Their  
5 costs or these costs reflect an original cost  
6 rate base and a regulated rate of return. And  
7 it is true that in these industries  
8 acquisition premiums are typically excluded  
9 from the regulated rate base.

10 But it's also important to recognize  
11 that original cost regulation is applicable  
12 only in situations in which the regulated  
13 entity is not subject to material competition.  
14 It is used in situations in which there is  
15 generally no concern about the ability of the  
16 regulated entity to earn an appropriate  
17 return.

18 And in fact in which there may be  
19 concern that absent regulation the regulated  
20 entity would earn more than an appropriate  
21 return. Thus this type of regulation protects  
22 both rate payers and investors. It guarantees

1       that rate payers pay no more than they should.  
2       It also guarantees that investors earn no less  
3       than they should.

4               In the rail industry investors enjoy  
5       no such protection. In the rail industry  
6       there is no rate base for rate regulation  
7       purposes. As we've heard, rates are set in  
8       the first instance based on market conditions  
9       and based on the demand that railroads  
10      perceive for their services.

11             Only in a handful of cases are rates  
12      set by the STB. And no rate is set based on  
13      original cost accounting. Thus the concerns  
14      that have been raised about possible perverse  
15      effects under original cost accounting don't  
16      arise. The perverse effects that have been  
17      cited have to, excuse me, have to do with  
18      circularity and the potential for a double  
19      counting, or double payment for the assets put  
20      in service.

21             Now the circularity concerns have  
22      been discussed before. I'm not sure if

1       there's much more to say other than that given  
2       all that we have heard about the fact that  
3       most rates are set by competition, that there  
4       is, excuse me, nothing analogous to a rate  
5       base that much of the acquisition premium went  
6       into good will, which has no effect on  
7       regulatory, any regulatory determination.  
8       There seems to be no concern here really about  
9       circularity.

10               And on the double counting issue, I  
11       think that this concern arises under original  
12       cost regulation when you have a situation  
13       where rate payers are paying rates that  
14       reflect a nominal cost of capital applied to  
15       an original cost rate base. In that  
16       situation, if it's applied consistently the  
17       compensation for inflation comes to the  
18       investor through the rate of return.

19               And there is a sense that if one  
20       were to allow acquisition premiums to go into  
21       place that there would be double payment.  
22       That situation doesn't arise in the railroad

1 industry. In fact, in the railroad industry  
2 no railroad has consistently earned its cost  
3 of capital.

4 And so in a real sense, the  
5 customers of the railroads haven't yet paid  
6 once for the assets that they use. Because of  
7 the nature of competition in the rail  
8 industry, the original cost regulation is  
9 fundamentally incompatible with rail markets.

10 Railroads are subject to material  
11 competition. Competitive rates vary more than  
12 regulated rates. They have a different  
13 pattern over time. If one were to try and  
14 subject the railroads to original cost  
15 regulation, at various points either the  
16 regulatory ceiling would bind or the market  
17 forces would constrain rates.

18 The result would be that the  
19 railroads would be left with the worst of both  
20 worlds. And they would be unable to earn a  
21 rate of return. Thank you.

22 MR. WEICHER: Chairman, would you

1 allow Mr. Hund an extra minute to recap for  
2 questions, is that correct?

3 CHAIRMAN ELLIOTT: Of course.

4 MR. HUND: Okay. So I'll make this  
5 very brief. First of all, as you can see on  
6 the slide, all post Staggers rail mergers used  
7 GAAP. And the Board should not depart from  
8 decades of established policy. There's no  
9 defensible rationale for changing the general  
10 application of this precedent.

11 But I think most importantly, it  
12 would be bad public policy to go to a world of  
13 ad hoc exception-based departures from GAAP  
14 for railroad accounting and costing. BNSF's  
15 policies and practice are to set rates based  
16 upon market conditions not regulatory cost.  
17 And as I think we all agree, there's only a  
18 minimal amount of regulated traffic that's  
19 potentially affected and only modestly. And  
20 that's in the 4 to 6 percent average change in  
21 URCS.

22 And the Board has effective remedies

1 available to address any transitional  
2 anomalies in existing cases or prescriptions.  
3 And as Mr. Weicher described, and you should  
4 use those in the cases where justified. And  
5 I'd like to address one final point and that's  
6 on, there's been discussion of synergies and  
7 benefits about the Berkshire acquisition. And  
8 I'd like to say that first of all it's  
9 incorrect to say there's no synergies.

10 I would describe them as very modest  
11 and modest being in the 10's of millions of  
12 dollars. For instance, we no longer have an  
13 arrested relations function. We no longer  
14 have an outside Board, audit committee,  
15 compensation committee, registration of stock,  
16 all of the fees that we pay associated with  
17 that.

18 So there's modest synergies, but I  
19 would never say they were enough to justify  
20 the acquisition. But I think the real  
21 benefits of Berkshire ownership of a railroad,  
22 a company like BNSF, are that Berkshire has a

1 long-term perspective. On the day of the  
2 acquisition Warren Buffet described it as this  
3 is day one of the first hundred years of  
4 ownership of BNSF.

5 And if I can simply describe the way  
6 cash works in the company. Berkshire doesn't  
7 demand an amount from us to pay back the  
8 premium they paid or anything like that. What  
9 they tell us is invest all the capital you  
10 need to maintain a strong railroad and invest  
11 all the capital you need that justifies  
12 expansion or efficiency, based upon good  
13 economic decisions. Send us the rest.

14 So I mean that's just wonderful from  
15 a CFO's perspective to have that type of  
16 owner. A great example was last year when we  
17 had significant flooding and we had hundreds  
18 of millions of dollars of damage in the second  
19 and third quarter.

20 We called Berkshire and said the  
21 dividend we had anticipated paying you is  
22 going to be less because we need to put our

1 railroad back in service. That conversation  
2 lasted five minutes. And they said we  
3 understand. Do what you need to do to  
4 maintain a strong railroad. Send us the rest.

5 And so then let's go back to a  
6 little bit of so why did Berkshire buy BNSF in  
7 the first place? Why is this a benefit? I  
8 mean, first of all Berkshire does have this  
9 long-term hundred plus year time horizon. And  
10 secondly they invest in what they perceive to  
11 be as solid businesses that generate  
12 reasonable returns.

13 And so as far as the railroad  
14 industry and BNSF in general, BNSF  
15 specifically rather, they're bullish on the  
16 long-term future of America. And they know  
17 that the railroads and BNSF specifically  
18 provide a great service to the economy of this  
19 country that they're bullish on.

20 So that's really the reason why  
21 we're now a subsidiary and have been for the  
22 last two years of Berkshire Hathaway. Thank

1       you for the extra time.

2                   CHAIRMAN ELLIOTT:  Thank you very  
3       much.  Commissioner.

4                   COMMISSIONER BEGEMAN:  Repeatedly in  
5       the testimony that several of you have given,  
6       you've talked about the accounting adjustment  
7       not having a meaningful impact or a minimal  
8       impact at best.  And I'm curious to know at  
9       what point would you agree that there is a  
10      meaningful impact that might warrant the Board  
11      taking a different approach to it following  
12      GAAP?

13                  MR. WEICHER:  If you're referring to  
14      in terms of rate cases, I think it would, well  
15      it would also really have to be a case by case  
16      situation if there was something aberrant in  
17      a particular transaction.  Anything like this  
18      that is currently in the single digits, the  
19      precedent you've seen and that Rob Jenkins  
20      took through is part of the endless evolution  
21      of railroads.

22                  Who knows what will impact future

1 costs of railroads and what makes a major  
2 impact to compare these things to. We make  
3 massive investments. We have investments  
4 we'll be making for things like PTC, we're  
5 always buying locomotives. So to put in  
6 perspective of the prior transactions this is  
7 quite modest.

8 I don't think, to be more direct,  
9 there's any absolute standard that you can  
10 envision. It would have to be in context to  
11 the dollars and the amount and what it did to  
12 cases.

13 Having said that, we really think, I  
14 really believe that if you look at your rate  
15 remedies, once your past the transition, once  
16 your past Stagger, there is no real impact,  
17 except at the margin or lost in the noise.  
18 Because all these standards, once it's in the  
19 comparable bases, take away the impact.

20 COMMISSIONER BEGEMAN: But for  
21 argument's sake, let's say 10 percent of grain  
22 shippers, of your grain shippers, no longer

1 meet the 180 percent market dominance  
2 threshold. Is that something we should  
3 consider?

4 MR. WEICHER: Frankly, I don't think  
5 that would be a substantial impact. But  
6 having said that, we have many rates,  
7 regulated rates, below 180 percent. There is  
8 this impression given by some of the speakers  
9 this morning that exempt rates, all our rates  
10 are driven with the market.

11 They admit exempt rates are and that  
12 some how those are down here and the others  
13 are up there. In reality, we have plenty of  
14 regulated rates below 180 percent. So I don't  
15 know how you would get to that point where  
16 you'd know that a given set of shippers or  
17 rates are above.

18 But having said that, I don't think  
19 10 percent would be enough to change something  
20 this established. This is also something that  
21 evolves over time.

22 COMMISSIONER BEGEMAN: Mr. Hund, I

1 think one of the comments that you made was  
2 that if we did go a different route you would  
3 be required to keep two sets of books. What  
4 would some other impacts be?

5 MR. HUND: I would say that, the  
6 biggest that I would say is by not following  
7 the precedent of GAAP, the two sets of books  
8 is I'll call it a modest administrative, I'll  
9 even call it a nuisance, okay. I mean, that's  
10 not a reason to do something or not do  
11 something.

12 It's really more the, what I all the  
13 introduction of uncertainty and uncertainty  
14 equates to risk. Because what we end up  
15 saying is then no one knows what the standard  
16 is. Because we're going to an ad hoc basis.  
17 We're going to a case by case situation.

18 So each transaction that takes  
19 place, whether it be a major merger or an  
20 acquisition of say a Class 2 or 3 something  
21 like that, we don't know what the regulatory  
22 framework will be and we've sort of broken

1 from a long pattern of history. And any time  
2 there's introduction of risk that is something  
3 that impacts a decision making process.

4 So I think there's, you know, it's  
5 much better to stay with a, first of all, a  
6 set standard that is enforceable and enforced  
7 by the SEC and is the requirement is at least  
8 25 years of precedent here at the STB and its  
9 predecessor agency and then deal with those  
10 exceptions that truly need to be dealt with.

11 COMMISSIONER BEGEMAN: With respect  
12 to the premium itself, is it safe to assume  
13 that you used a replacement cost approach in  
14 developing the \$8.1 billion figure?

15 MR. HUND: I would say it's  
16 different from replacement cost modestly.  
17 It's very, very close. But first of all, we  
18 did it as of a specific date, which was the  
19 10th or 12th rather of February 2010. So it  
20 wouldn't necessarily be a replacement cost  
21 today or any time a balance sheet's issued,  
22 it's just as of one date.

1                   When we typically talk about  
2           replacement cost we say as of each balance  
3           sheet date you're measuring replacement cost.  
4           So I guess you could argue it was, you know,  
5           close as of that date.

6                   And then it comes down to  
7           replacement cost. Let me make sure that, I  
8           know I talked about this, but we talked about  
9           the fact that we looked at the productive  
10          capacity and not replacement of assets in  
11          place.

12                   And a great example of that is, we  
13          have three lines going from, through the State  
14          of Washington out to the Pacific Northwest,  
15          and they work three different ways through the  
16          state. Now we assume that we had one more  
17          substantial line going through the State of  
18          Washington and eliminated all the duplicative  
19          routes.

20                   We looked at our facilities in  
21          Chicago where we have four major facilities  
22          spread out throughout the city and assume that

1 all that was one. So we didn't just replace  
2 what existed, we replaced productive capacity.  
3 So with, I guess those caveats, I'd say it's  
4 fairly close to what you would define as  
5 replacement cost.

6 COMMISSIONER BEGEMAN: Before my time  
7 here the Board had a proceeding. I think it  
8 was initiated at the request of industry --  
9 to consider a replacement cost approach, which  
10 was rejected. How does what you have  
11 done then compare with the book  
12 value for the rest of the industry? Should  
13 they be given the opportunity to --

14 MR. WEICHER: Commissioner, if I  
15 may, I participated in that proceeding and  
16 there are some important distinctions. I  
17 believe you're referring to the proceeding  
18 that came before the Board to adopt  
19 replacement cost for costing purposes for  
20 revenue adequacy purposes as a basic base.

21 That was more of a replication of  
22 entire systems as opposed to the functional

1 utility approach Tom Hund described. The  
2 Board rejected that and they rejected it in  
3 part because the Board didn't, as I recall or  
4 read it, did not feel it adequately dealt with  
5 surplus assets or how to look at the current  
6 condition of the assets.

7 The accounting driven study that Tom  
8 Hund referred to is not the replication of  
9 today's system in full on a replacement cost  
10 basis. It is this functional utility concept  
11 to serve our customers and is a different  
12 number. But it was also driven by this  
13 accounting process, not by the regulatory  
14 elements that were before the Board in the  
15 replacement cost case.

16 MR. JENKINS: Let me try it. The  
17 other thing that is different is, what was at  
18 issue there was calculating replacement cost  
19 every year and coming up with a system where  
20 you revalued every year and applying a real  
21 cost of capital to that. And the Board  
22 determined that it was just impractical to do

1       that every year. So did the RAPB.

2               But that didn't prevent the RAPB  
3       from deciding that you ought to apply a  
4       nominal cost of capital to GAAP purchase  
5       accounting when you had a purchase. So it's  
6       apples and oranges. Because what we have here  
7       is we have GAAP purchase accounting and as Mr.  
8       Hund just testified, it's frozen in place.

9               COMMISSIONER BEGEMAN: So help me  
10      understand how your write up of \$8 billion  
11      compares with previous acquisition write-ups.  
12      I think, there was a \$3 billion markup for one  
13      entity, et cetera. I mean the \$8 billion is  
14      quite large in comparison to other actual  
15      merged carriers.

16              Did they not use a replacement cost  
17      approach? I understand you can't quite  
18      comment on their approach because you were not  
19      participating, but it --

20              MR. JENKINS: Well, first of all the  
21      industry was much smaller then. So these were  
22      smaller railroads and the transactions --

1                   COMMISSIONER BEGEMAN: But the UP/SP  
2 merger, I would not consider small.

3                   MR. JENKINS: I said smaller. I  
4 didn't say small. No there was still  
5 significant money involved. But the, as we  
6 discussed, as Mr. McBride was talking about --

7                   COMMISSIONER BEGEMAN: The value  
8 just wasn't there.

9                   MR. JENKINS: The values just  
10 weren't there. But the percentage increase  
11 was sometimes, well in almost every case was  
12 greater than the percentage increase here.

13                   (Off microphone comment)

14                   So yes, UP, Professor Weil is  
15 pointing out to me that UP SP the increase was  
16 74 percent. And nobody raised a question  
17 about using acquisition costs there.

18                   Now you did have another question  
19 which is should now we raise every other  
20 railroad's investment base. And --

21                   COMMISSIONER BEGEMAN: Which I know  
22 the other witnesses before you would certainly

1       strongly support.

2               MR. JENKINS:   Well, Professor Weil  
3       would you like to --

4               DR. WEIL:   One of the operable  
5       principles in economics is you don't let the  
6       best be the enemy of the good.  I've said that  
7       in my report.  We say it all the time in  
8       policy.  It would be best if we could  
9       costlessly learn the opportunity cost of every  
10      asset at every balance sheet date every single  
11      quarter.

12              But the world doesn't work that way.  
13      To get these data is expensive.  I don't how  
14      much BNSF spent to get that allocation of the  
15      \$8 billion to the assets.  But if it were  
16      possible to do it every year, I think the  
17      policy should be to do it every year.

18              But since we don't want to spend  
19      those resources getting those data, we take it  
20      when we get it.  When you have a purchase  
21      acquisition, generally accepted accounting  
22      principles require that you spend what it

1 takes to get the right data. It would be nice  
2 to do that every year for every company. But  
3 and you could I suppose require it, but it  
4 would be an expensive undertaking.

5 MR. WEICHER: And, Commissioner, if  
6 I may. We are asking you to adhere to  
7 precedent for applying GAAP for the purchase  
8 accounting adjustment in an acquisition. That  
9 is different than what you do in an industry  
10 wide basis. We'd be following the same  
11 precedent here you've done in prior merger  
12 cases.

13 That does not require or drive  
14 changing other precedent. You looked at this  
15 other issue a couple of years ago. These  
16 issues keep coming back and when and if you  
17 see fit that can be addressed. But this does  
18 not compel any change in other standards,  
19 following precedent in this transaction.

20 CHAIRMAN ELLIOTT: Just a few  
21 questions. I guess I'll ask the question I  
22 asked the shippers only to be fair. Back in

1 the late 80's when we were addressing some of  
2 these issues about what type of accounting to  
3 use I believe that you took the opposite  
4 position, the railroads did. And I guess the  
5 question is the same. What has changed since  
6 then? Or what reason is there for taking the  
7 flip side of this?

8 MR. WEICHER: Two elements and I  
9 think two of us at the table were practicing  
10 for the STB at that, ICC at that time. First  
11 there were basic differences like has occurred  
12 in other industries of the value of the assets  
13 compared to the market being under as opposed  
14 to over.

15 Having said that, BNSF has never  
16 taken a different position. And may it was  
17 probably part of industry groups our  
18 predecessors were they were different. And  
19 those were different situations.

20 Having said that, the Surface  
21 Transportation Board and its predecessor the  
22 ICC, have stayed consistent through all of

1       this.

2                   MR. JENKINS: I would also point out  
3       that the AAR's position back then was that the  
4       value of the railroad's assets had been driven  
5       down by poor regulatory policy, which I  
6       continue to believe to this day.

7                   The ICC in response to that said our  
8       decision will be driven by what is the most  
9       accurate and reasonable valuation in each  
10      particular case. If we find that the  
11      acquisition price was held down or depressed  
12      primarily as a result of government action or  
13      policy, then use of acquisition cost would not  
14      be appropriate.

15                  Where the AAR lost in that  
16      proceeding, was in convincing the ICC that in  
17      fact their rates had, that their investment  
18      bases had been driven down by poor regulatory  
19      policy. The ICC took the position that  
20      because most of the rates in the country were  
21      set by market demand that they didn't feel  
22      that there had been a material effect as a

1 result of the regulatory policy.

2 And so, and that they were going to  
3 adopt a uniform position since it would apply  
4 both ways, whether the sale was for above or  
5 below book value. So the AAR's position was  
6 a, was based upon an honest belief, but the  
7 AAR lost.

8 CHAIRMAN ELLIOTT: And that would be  
9 my answer. I lost and now I'm found, in the  
10 law. So having lost many cases in my career,  
11 surprising. The other question, and it  
12 actually came from the same section in the  
13 shipper's brief regarding double counting of  
14 inflation, and I'll, it's from Page 40 of  
15 WCTL's joint opening statement and it's a  
16 direct quote from the rail member of the RAPB.

17 And the quote is, "If the purchased  
18 railroad is financially strong, continued  
19 inflation will have driven up the current  
20 values of its assets well above depreciated  
21 original cost of its long-lived investments.  
22 The acquisition price will, therefore, be

1 higher and the new owner would have the  
2 ability to raise rail rates to higher levels  
3 than would be allowed under current ICC  
4 practice.

5 Shippers which have paid once for  
6 the impact of inflation could be called upon  
7 to pay twice for the same escalation of  
8 values. This is the same type of double count  
9 for inflation the Board assiduously avoided in  
10 its pronouncements on abandonment and cost to  
11 capital questions."

12 Obviously back then you were, you  
13 know, supporting the shipper's positions, and,  
14 but I wonder, it seems that statement is  
15 different than the statement you've been  
16 making here today about the effect of the  
17 double count of inflation by using nominal  
18 cost to capital.

19 MR. JENKINS: This is Mr. Briggs'  
20 statement?

21 CHAIRMAN ELLIOTT: That's correct.

22 MR. JENKINS: Yes. It's wrong. I

1 mean the fact of the matter is that the state  
2 of play back then in the mid 80's was such  
3 that we were unsure how regulation was going  
4 to play out. And as it's played out it has no  
5 effect or minimal effect.

6 CHAIRMAN ELLIOTT: Okay. Well I  
7 appreciate your candor admitting that your  
8 predecessors were wrong. Is he still alive,  
9 Mr. Briggs? Next question, just in listening  
10 to your testimony I'm hearing that there  
11 isn't, your position is there's not going to  
12 be a great effect as a result of this asset  
13 write up.

14 And I guess the question is, you  
15 know I asked the question about SAC and I tend  
16 to agree with what Mr. Weicher was saying,  
17 that going forward in SAC it may not be really  
18 an effect that you would have. Then the other  
19 side raised the issues with respect to the  
20 Western Fuel case.

21 And I thought I heard some pretty  
22 positive responses from you that could be

1       dealt with. And would you be comfortable in  
2       dealing with those two cases in the way that  
3       you mentioned with respect to the link?

4               MR. WEICHER: Chairman, comfortable  
5       is a term that I'm not sure exactly how to  
6       say. But that would be the appropriate and  
7       right way to deal with the issue if you see an  
8       issue there.

9               CHAIRMAN ELLIOTT: Sure.

10              MR. WEICHER: We don't throw out a  
11       system and take, disregard 25 years of  
12       precedent. If there are a couple of  
13       situations that seem anomalous or transitional  
14       or are in an unanticipated situation as a  
15       result of this transaction, you can and if you  
16       feel that way should address them in those  
17       cases. Because it's not that complicated to  
18       fix it there if it needs to be fixed and leave  
19       the basic structure of railroad costing and  
20       accounting intact following your precedent.

21              CHAIRMAN ELLIOTT: And then if we  
22       handled it, you know, separately in the

1 specific cases themselves and then my  
2 understanding, other than the jurisdictional  
3 threshold moving a bit and then if you did  
4 have a case that was under 180 there might be  
5 some effect. But overall what I'm hearing is  
6 there's not a huge amount of effect that  
7 you're seeing. So I guess the broad question  
8 I have is why exactly are we here fighting  
9 over this?

10 MR. WEICHER: Well the petition was  
11 brought by the other party. But we think at  
12 the end of the day the right principles for  
13 accounting for regulatory costing and  
14 accounting for this transaction should be  
15 followed for long-term consistency,  
16 predictability and to avoid uncertainty. This  
17 is all driven by external requirements of SEC  
18 and GAAP. And it should be done the right  
19 way.

20 MR. HUND: That's right. I actually  
21 in one of my answers, I think to Commissioner  
22 Begeman's earlier question is to go to an ad

1        hoc basis of determination of the proper way  
2        simply introduces uncertainty and risk and all  
3        that associated with every transaction, every  
4        purchase of anything that's done. And we  
5        think sticking with the long-standing  
6        precedent and dealing with the limited number  
7        of exceptions to make sure that there is, you  
8        know, action can be taken on those is a much  
9        more appropriate way to go.

10                DR. WEIL: Can I speak on that? We  
11        give the theorist approach. There's no  
12        question that uncertainty increases risk. Now  
13        how does that effect a business man? It  
14        increases the discount rate that he uses to  
15        get the present value of cash flows projected  
16        from projects.

17                When you have more risk, more  
18        uncertainty it's a bigger discount rate, gives  
19        you smaller present values and it means at the  
20        margin there will be fewer projects that you  
21        would undertake than when you have the  
22        certainty of the regime going forward to make

1 decisions.

2           So I would think, from an outsider,  
3 an academic, the main reason they'd like to  
4 get this done is so that they can have the  
5 level playing field that they can anticipate  
6 for making business decisions going forward  
7 and not have to worry about the uncertainty  
8 that will induce them at the margin to reject  
9 projects that would be otherwise a good deal  
10 for everybody.

11           CHAIRMAN ELLIOTT: Last question.  
12 And it goes to one of the questions I asked  
13 the shippers, but you look at the results here  
14 also with respect to revenue adequacy and  
15 obviously by allowing the write up that you  
16 all become farther away from revenue adequacy  
17 as a result of the write up and I don't think  
18 that's disputed.

19           And something seems inherently, you  
20 know, wrong about that because nothings really  
21 changed. Now this gets to the proposal I made  
22 to the other side which was warmly received

1 and that is a joke for the record, with  
2 respect to having a phasing in of the write up  
3 and as a result taking some of the perceived  
4 inequities out of the mix.

5 How do you feel about a possible  
6 phasing in, especially considering that there  
7 isn't this grand effect that we're seeing that  
8 you said that won't occur as a result of this  
9 write up?

10 MR. HUND: I'll start and then, Rick  
11 can clean up whatever I get wrong here. I  
12 mean, I'd say that, it certainly wouldn't be  
13 our preferred alternative, which of course you  
14 know. But I think, you know, as an  
15 alternative it's possible.

16 I think there would be two issues to  
17 deal with. One is what's the appropriate  
18 period of time. And so we think perhaps if it  
19 was over a relatively short period of time, a  
20 number of years, perhaps something like that  
21 could work. But the time period would have to  
22 be dealt with.

1           And secondly, the mechanism by which  
2       you do it. I mean, it's hard to answer in the  
3       affirmative or negative without understanding  
4       necessarily maybe some of the details and how  
5       you would deal with it, but I, I'll say it is  
6       possible. Does that, go ahead and clean it  
7       up, Rick.

8           MR. WEICHER: I will certainly not  
9       correct our CFO. I will say --

10          CHAIRMAN ELLIOTT: Good thinking.  
11       Good career move.

12          MR. WEICHER: I will say as a matter  
13       of regulatory principle, it would not be  
14       correct. It would induce or inject again this  
15       sort of ad hoc treatment. This Board and its  
16       predecessor have had many, many major mergers  
17       of vast consequences they've dealt with for  
18       the last 25 years.

19          And they've had some consistent  
20       rules in consistent areas, including following  
21       GAAP. Following GAAP the way it comes through  
22       that Tom Hund explained and Professor Weil has

1 described. So you ought to stay with the  
2 rules in these areas to have consistency and  
3 avoid sort of exception-based deviations. But  
4 it's of course possible.

5 CHAIRMAN ELLIOTT: Thank you. Vice  
6 Chairman.

7 VICE CHAIRMAN MULVEY: A couple of  
8 minor questions. I was interested in the  
9 process by which the, I guess it was Ernst &  
10 Young, divided up the premium to good will and  
11 asset valuations. I saw the submissions but  
12 was the Ernst & Young study part of the  
13 submissions? Is that available?

14 MR. WEICHER: Extensive work papers  
15 were provided. There were work papers given,  
16 made available to the parties. They were made  
17 available to the staff. I don't know that I  
18 can address the studies are out they're not --

19 VICE CHAIRMAN MULVEY: Mr. McBride  
20 suggested it was a black box and that the  
21 principal spokesperson for the other side  
22 didn't seem to know exactly how the \$8 billion

1 was carved out. And you mentioned, I did know  
2 this, that there were 6,600 miles of rail  
3 rights-of-way that were not valued because  
4 they were either duplicative. So,  
5 theoretically if you valued the entire  
6 railroad, including that 6,600 miles, you  
7 could have assigned even more to assets than  
8 only the \$8 billion. Is that correct?

9 MR. HUND: Yes.

10 MR. WEICHER: And it's a bit higher.  
11 But again this was not, sorry --

12 MR. HUND: If you simply replaced  
13 what existed, it would have been a  
14 substantially higher number. And even if you  
15 took the locomotive's freight cars and simply  
16 said, you know, they exist therefore I'll  
17 assign a value and, you know, whatever that  
18 would be, I mean, many of those we assigned  
19 zero value because of the time in the economic  
20 cycle we were doing this as of too.

21 VICE CHAIRMAN MULVEY: The proper  
22 valuation of the railroad, replacement cost

1       versus book value, is an issue that's been  
2       before the Board several times. The Board has  
3       in the past rejected replacement course and  
4       largely for the reasons that Professor Weil  
5       has mentioned and that is it's very difficult  
6       to do, especially on an ongoing basis.

7               Having said that, it is true it has  
8       been done before. I believe back in 1920  
9       their Valuation Act required that the nation's  
10      railroads be appraised. Mr. McBride, I guess,  
11      is the only one who remembers that. But he  
12      and I were there for that. And they did value  
13      the railroad. But today it is very difficult  
14      to determine what will need to be replaced and  
15      what is redundant and will probably not be  
16      replaced. And finally exactly what is the  
17      true value of the remaining assets.

18             Having said that, I think it is also  
19      true that economic analysis suggests that the  
20      opportunity cost, the replacement cost is  
21      probably the "better" measure. But it may not  
22      be an attainable one and as Professor Weil

1 pointed out, you can't let the best be the  
2 enemy of the good. I'm also an economist. It  
3 is a fundamental theory of economics.

4 You also said that costs do not  
5 affect railroad rates. Is that true of PTC  
6 and coal dust and all of those other costs?  
7 It struck me from pleadings in those cases  
8 that there were decisions that these increased  
9 costs certainly were something that needed to  
10 be incorporated in rail tariffs, which  
11 therefore would be reflected in the railroad  
12 rates. Would you want to clarify that  
13 assertion a bit?

14 MR. WEICHER: We certainly spent a  
15 great deal of time justifying rates before  
16 this agency involving costs. And costs are of  
17 course relevant, the cost of service is of  
18 course relevant to the rates we charge. The  
19 point that our testimony has shown as Tom Hund  
20 said again this morning, we've said our rates  
21 are not driven by regulatory costs.

22 There is a distinction. And when we

1 defend our rates in the regulatory arena of  
2 course we have to look at the costs and there  
3 are issues of what costs should be  
4 attributable to what movements as part of this  
5 regulatory function in all these different  
6 rate cases. That is distinct from whether we  
7 in the marketplace are being set, are setting  
8 rates based on regulatory costs. Other than  
9 of course when the Board prescribes something.

10 VICE CHAIRMAN MULVEY: There's been  
11 some talk about the jurisdictional threshold  
12 and how this might affect the number of  
13 railroads, the number of shippers rather who  
14 are affected by the jurisdictional threshold,  
15 easy for me to say. Do you think the Congress  
16 ought to revisit the jurisdictional threshold?

17 It's never been clear to anybody  
18 exactly or precisely where the 180 ratio came  
19 from. Is this something that perhaps we ought  
20 to move away from, maybe not even have a  
21 jurisdictional threshold, but rather look more  
22 at a qualitative assessment as to whether or

1 not the railroad is market dominant rather  
2 than having the 180 R/VC rule?

3 MR. WEICHER: Vice Chairman, if I  
4 may, from a general regulatory standpoint I  
5 will try to make this brief because one of  
6 your prior speakers might have, I'm not going  
7 to give some long extrapolation as Mr. McBride  
8 did. The regulatory standards can always be  
9 subject to revision and improvement.

10 There are issues involving the way  
11 the Board applies its market dominance  
12 standards, whether they are broad enough and  
13 include product and geographic and so forth.  
14 But through Congress' direction and then the  
15 rulemakings the Board has done, it has a  
16 structure in place.

17 And I will certainly defer to  
18 broader authorities and I think we would, it's  
19 not part of this proceeding whether at some  
20 point as just has been the discussion the last  
21 couple of years, there should be changes to  
22 some of these regulatory standards. Having

1 said that, the revenue to variable cost  
2 threshold, as long as it's there in Congress  
3 should be driven by the most correct cost.

4 And if I could make a comment on one  
5 thing you asked before, if I could go back for  
6 one minute about the dispute over the 8  
7 billion level. That was really coming into  
8 this hearing not something that had been  
9 picked at. It was a lot of rhetoric we heard  
10 today that suggests there's something there to  
11 be concerned about.

12 In any event, the 180 is probably a  
13 little like another one of those things. I  
14 have heard the same things and I think I have  
15 heard you speak to the derivation of where the  
16 180 comes from and whether it's really  
17 shrouded in mystery or what it was. And it  
18 sounds like it was a number that was decreed.  
19 And until it is otherwise decreed, I guess  
20 we'll live with it.

21 VICE CHAIRMAN MULVEY: My last  
22 question is you mentioned that only 2 percent

1 of total shipments would be affected. Two  
2 percent of what? When you say total shipments  
3 is that total number of shipments, value of  
4 shipments, ton miles? You know there are so  
5 many ways in which it can be measured, and you  
6 get a different number depending upon how you  
7 look at it.

8 MR. HUND: Yes. I think actually in  
9 my testimony I described it as less than 2  
10 percent of the 9 billion shipments in 2010,  
11 I'm sorry 9 million shipments in 2010. And a  
12 shipment would be defined as a rail car, a  
13 container or a trailer.

14 VICE CHAIRMAN MULVEY: So it could  
15 be more in terms of tons, more or less in  
16 terms of ton miles, more or less in terms of  
17 revenues depending upon what other things --

18 MR. HUND: Sure, I mean, if we  
19 measured those, I mean, I'm not sure what the  
20 measurement, whether it would be more or less.  
21 But it would be, you know, it would be a  
22 different number if you looked at revenue

1       versus ton miles versus any other metric,  
2       sure.

3               VICE CHAIRMAN MULVEY:   Right.   Okay,  
4       thank you very much.

5               CHAIRMAN ELLIOTT:   If it was 9  
6       billion we wouldn't be here today probably.

7               MR. HUND:   Yes.   Sorry about that.

8               CHAIRMAN ELLIOTT:   Thank you very  
9       much.

10              MR. HUND:   I've always had trouble  
11       with numbers.

12              CHAIRMAN ELLIOTT:   I can understand.

13              VICE CHAIRMAN MULVEY:   A billion  
14       here, a billion there, pretty soon --

15              MR. WEICHER:   Thank you very much.

16              CHAIRMAN ELLIOTT:   I'll now call  
17       Panel Number V, which is the railroad  
18       interests.   This is the Association of  
19       American Railroads.   Welcome and Mr. Gray, you  
20       have ten minutes.

21              MR. GRAY:   Thank you, Mr. Chairman.  
22       Good afternoon.   My name is John Gray.   I'm

1 Senior Vice President of Policy and Economics  
2 for the AAR. And in that role I participate  
3 frequently in AAR's representation of the  
4 railroad industry before a variety of  
5 government regulatory bodies. Including our  
6 participation in front of the STB,  
7 particularly on a regular basis in the cost of  
8 capital determinations. The cost indices and  
9 a number of other areas.

10 In the past, prior to coming to AAR  
11 I was in the rail industry directly for 27  
12 years, both Class 2 and Class 1 railroads.  
13 Over half that time spent in the marketing  
14 organizations of those railroads. The rest of  
15 it in strategic planning, network planning and  
16 network management. And as an aside in that,  
17 I would mention that during those times in  
18 marketing, just to address very briefly an  
19 earlier question that has come up, in the  
20 course of thousands of pricing activities  
21 meeting with literally thousands of customers  
22 during that time, at no time did I ever or did

1 anyone that reported to me, as far as I know,  
2 ever know what the URCS cost of a move was.

3 That simply was not something that  
4 was a part of what you did. It was, you were  
5 expected to work at the market and URCS cost  
6 was not used at all.

7 However, the purpose of my testimony  
8 here today is to address the proposal the WCTL  
9 has brought forward to substitute predecessor  
10 cost for GAAP acquisition costs in the BNSF  
11 acquisition for the purposes of revenue  
12 adequacy and URCS costing purposes.

13 First of all, note that GAAP  
14 acquisition cost is at this point required by  
15 the Board's rules. And the Board has applied  
16 these rules to merger and acquisition  
17 transactions since the late 1970's. And I  
18 would emphasize in that is both merger and  
19 acquisition transactions.

20 This is not the first time that the  
21 ICC or the Board's use of acquisition costs  
22 has been challenged. But when the agency's

1 position's been challenged, whether by AAR as  
2 you have noted in the past, or by shipper  
3 groups, it has reached the same conclusion  
4 that GAAP acquisition cost is the right policy  
5 and the right rule for the railroad industry  
6 to follow.

7 It is not my intent in this  
8 testimony to discuss either, to refer to  
9 reports or decisions of the RAPB, the ICC or  
10 the STB or the courts on the issue. Quite  
11 frankly, the written record that's already in  
12 this proceeding already does that quite  
13 adequately.

14 Rather as someone who has had  
15 experience in conducting and supervising the  
16 economic, financial cost studies of the rail  
17 industry, and as I said have been involved in  
18 numerous negotiations on pricing in the rail  
19 industry and who in my current position needs  
20 to be mindful of the ways that management,  
21 investors and the STB and others use railroad  
22 data, I would like only to stress a few points

1 in my testimony.

2 First, the Board should use the  
3 costs that are most economically accurate.  
4 You've heard this already today. But in  
5 fulfilling its regulatory obligations it's our  
6 belief that the economic accuracy of these  
7 costs is imperative.

8 Second, the Board should not deviate  
9 from applying the rules that are most  
10 economically accurate because of a  
11 particularly party's desired result. This has  
12 been the Board's policy in the past and should  
13 continue to be as we go forward.

14 And third, the Board should apply  
15 its rules evenhandedly in all merger and  
16 acquisition transactions. As the agency  
17 responsible for economic regulation of the  
18 rail industry, the Board should be trying at  
19 all times to use cost data insofar as it is  
20 practical that reflect current economic  
21 conditions.

22 In this regard GAAP acquisition cost

1 is economically superior to predecessor cost  
2 for railroads in merger and acquisition  
3 transactions. Because acquisition cost  
4 measures a railroad's current costs at the  
5 time of the transaction. In other words, it  
6 measures the ability of the assets that the  
7 railroad has in hand to produce value for its  
8 shareholders and for the rail entity going  
9 forward.

10 No one has argued in this case that  
11 the out of date predecessor costs would be  
12 more economically accurate than the GAAP  
13 acquisition cost. And they could not  
14 realistically do so. Even the arguments  
15 you've heard on accuracy have tended to be in  
16 terms of the accounting accuracy.

17 Again, as Professor Weil mentioned  
18 earlier, the real issue here is not the  
19 accounting accuracy, it's the economic  
20 accuracy. For example, as Mr. Hund testified  
21 earlier, the market value of the stock of BNSF  
22 at the time of the acquisition was already

1 twice the book value before Berkshire  
2 purchased BNSF. And no one other than Mr.  
3 McBride's oral testimony a bit earlier,  
4 contends that the purchase price paid by  
5 Berkshire was not negotiated as an arms length  
6 transaction.

7 It is plain, quite frankly, that the  
8 market had already spoken long before the  
9 Berkshire transaction and that the book value  
10 of BNSF assets bore no meaningful relationship  
11 to their economic value. Again the economic  
12 value, their ability to produce future income  
13 streams.

14 The book value is similarly  
15 unrelated to the replacement costs of the  
16 assets. The values established the GAAP  
17 accounting process are unquestionably more  
18 accurate in these economic terms than are  
19 their predecessor values.

20 My second point is that the RAPB,  
21 the ICC and the STB, have consistently  
22 endorsed and applied GAAP acquisition costs

1 based on a sound policy, not based on a  
2 desired result. The agency applied  
3 acquisition costs to transactions when  
4 railroads were purchased for less than book  
5 value because it determined that the  
6 acquisition cost more closely measured the  
7 railroad's current economic value, its  
8 current, its prospects looking forward.

9 I am not aware that the shippers  
10 objected to the use of acquisition costs in  
11 those circumstances. In fact, as we've noted  
12 today, there have been a number of cases in  
13 which they actively supported it.

14 The ICC and STB have also applied  
15 acquisition costs when railroads were acquired  
16 for more than book value. Again because the  
17 agency determined that the acquisition cost  
18 more closely related to the railroad's current  
19 economic value.

20 To the extent that certain shippers,  
21 parties now say that they don't like the  
22 acquisition cost in this transaction where the

1 railroad is purchased for more than book  
2 value, quite frankly, you can't have it both  
3 ways. You have to have some level of  
4 consistency as Mr. Weicher pointed out and I  
5 believe Mr. Hund echoed, the market demands no  
6 less of a level of consistency.

7 Economic costs are economic costs  
8 regardless of who advocates what principles.  
9 And the Board's decisions should be driven by  
10 the most accurate economic data available. In  
11 this case the GAAP, the accounting based on  
12 the GAAP principles.

13 Finally, it is important to stress  
14 that the industry, investors and the public  
15 rely on consistency and predictability and  
16 evenhanded application of the Board's rules.  
17 The railroad's books are maintained for SEC  
18 reporting purposes as well as R-1 reporting  
19 purposes on the basis of GAAP purchase  
20 accounting.

21 Virtually every major railroad in  
22 the United States has been involved in a

1 significant merger or acquisition transaction  
2 in the past 25 years, in some cases several  
3 merger and acquisition transactions over that  
4 period. And all these transactions have been  
5 handled under GAAP purchase accounting,  
6 including of course the one, Mr. Chairman,  
7 that you noted the Blackstone acquisition of  
8 CNW.

9 In asking for a suspension of GAAP  
10 accounting in the BNSF acquisition, WCTL is  
11 essentially asking the Board to reject the  
12 same financial principles to which financial  
13 institutions providing information to the  
14 public are consistently held. These  
15 principles, consistency and fairness in  
16 reporting and embedded in GAAP accounting.

17 These principles do not change based  
18 upon a particular party's desired outcome.  
19 Rather they demand the facts be reported in a  
20 transparent manner that markets and their  
21 participants, whether individual,  
22 institutional or public investors, can rely on

1 the accurate economically sound  
2 representations for market values.

3 The Board should continue to apply  
4 its rules evenhandedly and uphold the  
5 acquisition cost principles just as it has  
6 consistently done in the past. Thank you and  
7 any questions?

8 CHAIRMAN ELLIOTT: Thank you, Mr.  
9 Gray. I don't have any questions. Vice  
10 Chairman?

11 VICE CHAIRMAN MULVEY: I just have  
12 one and that is the AAR represents all the  
13 railroads, all the Class 1 railroads and some  
14 of the larger regional railroads. Does  
15 allowing BNSF to write up the acquisition  
16 premium give it a competitive advantage vis a  
17 vis the other Class 1 carriers?

18 BNSF's write up values means its  
19 assets are measured using something far closer  
20 to replacement costs than the Board allows in  
21 other contexts. So is it appropriate for UP  
22 to be closer to revenue adequacy than BNSF

1 simply because BNSF was able to take advantage  
2 of purchase accounting because it was  
3 acquired? Or should we find some ways to  
4 treat them all the same?

5 MR. GRAY: Again, I think it was put  
6 quite correctly earlier that we can't, you  
7 know, we can't allow the perfect to be the  
8 enemy of the good in this case. And quite  
9 frankly, there are certainly changes, but in  
10 the relative position of the companies because  
11 of this.

12 But the fact remains that all of  
13 these companies are making their decisions on  
14 how they approach the market on the basis of  
15 the market. And they are making those  
16 regardless of what their asset base valuation  
17 is.

18 The fact is that they are all  
19 looking at the market as to the opportunity  
20 that is available, not based upon some  
21 underlying financial basis. And when they're  
22 doing that, quite frankly, the end of year

1 financial statement is not going to be based  
2 upon the regulatory value of the company. It  
3 is going to be based upon their performance in  
4 the market and their ability to attract  
5 customers within that market and price  
6 appropriately.

7 VICE CHAIRMAN MULVEY: Thank you.

8 CHAIRMAN ELLIOTT: You're off the  
9 hook. Okay. We'll call up our final panel,  
10 which has appeared before us before for  
11 rebuttal. I believe you have 15 minutes on  
12 rebuttal.

13 MR. LESEUR: Okay. Well it's been a  
14 long day with no breaks. So we'll try to keep  
15 it short and sweet here. I just wanted, I  
16 started out earlier today with, from an  
17 outline of our position and I just want to go  
18 through some of the points I made before just  
19 to see where we are.

20 The question that, you know, we  
21 raised initially and we think the fundamental  
22 question in this case is should BNSF's captive

1 shippers pay higher rates simply because BNSF  
2 ownership has changed hands? And what I think  
3 we heard from the BN is basically the answer  
4 to that question is yes with some potential  
5 caveats to the deal with AEPCO and Western  
6 Fuels.

7 And they have a, their big picture  
8 is that most folks won't be injured. But the  
9 bottom line is their saying, yes. Rates  
10 should go up. And, you know, in going through  
11 our list we said, you know, there's no  
12 question Berkshire paid a premium to acquire  
13 BNSF and that for STB purposes it equals 8.1  
14 billion.

15 There's been a lot of questions  
16 about, you know, the 8.1 billion in terms of  
17 is that a good number, a bad number. And one  
18 of the things we did in this case and I don't  
19 think it's in the record because we handled it  
20 with BNSF counsel, is we sent a letter to  
21 BNSF, we being Slover & Loftus in October 12,  
22 2011, basically said, you know, we'd like to

1 have the back up for the, you know, how you're  
2 coming up with the \$42 to \$9.9 million. How  
3 it was pushed down? How asset values were  
4 allocated based upon their respective fair  
5 market values?

6 And we were trying to get at some of  
7 this, the accounting reports. And we were  
8 told in no uncertain terms by Mr. Jenkins in  
9 a letter he sent to us on October 17, 2011,  
10 that we couldn't have those. So, as I said  
11 earlier you know, we basically, given what we  
12 were trying to do in this case we didn't get  
13 into whether that number was accurately  
14 calculated or not.

15 We just for the purpose of what we  
16 were doing here we were trying to get the  
17 premium out. It was secondary to what we're  
18 trying to do here how much it exactly was. So  
19 that was the decision we made there.

20 And on this, you know, a fairness  
21 point I think that the BN said today, I guess  
22 for the first time that, you know, there may

1 be some synergies involved with this  
2 transaction. But I believe they said it  
3 wasn't enough to offset the premium. And, you  
4 know, I don't think they disagreed with the  
5 proposition that this premium will generate  
6 increased rates on some folks.

7 In terms of what other utility  
8 regulators are doing, I don't think the BN  
9 disagreed that no other public utility  
10 regulator in the country would permit the pass  
11 through of an acquisition premium on the facts  
12 presented in this case. They simply say that  
13 STB regulation is different.

14 And the point that we've been trying  
15 to make here is in the fundamental principle  
16 of protection of captive utility customers,  
17 that they shouldn't pay higher rates if their  
18 service hasn't changed. That principle  
19 applies across the board.

20 We also said we believe the Board  
21 has the legal authority to remove the premium  
22 for BNSF URCS. And, Mr. Chairman, I know you

1 asked some questions about it. And I think,  
2 you know, the legal requirements are it is a  
3 case by case consideration we think under  
4 Section 10707 involves market dominance under  
5 Section 1 which involves maximum rate  
6 reasonableness.

7 The Board clearly has the authority  
8 to remove the premium from BNSF's URCS and  
9 from the net investment base for revenue  
10 purposes. And just to be clear here, we're  
11 not asking that the Board change its system of  
12 accounts.

13 We're not asking how BN does its  
14 regulatory accounting. What we're asking for  
15 is when the staff gets this information and  
16 develops an URCS, which is a Board product  
17 that's used in Board proceedings for very  
18 specific purposes, that the Board staff remove  
19 the premium.

20 We're not asking that a fundamental  
21 change in the Board's accounting rules in how  
22 the BN actually reports data to the Board.

1       There's a lot of discussion about uniformity.

2               We're talking here about asking the  
3       Board to take an action to evolve its costing  
4       system which is used for very specific  
5       purposes, principally to set rates in rate  
6       cases. And that's why we wanted to come out  
7       because of the adverse impact inclusion of the  
8       premium has on captive customers.

9               We're not asking for wholesale  
10       change in the way BN does its reporting, how  
11       the R-1's are put together or anything of that  
12       nature. You know, the BN also repeated today  
13       the same arguments its made, you know, in its  
14       briefs. It asks the Board to treat this case  
15       as an accounting case.

16              And we had pointed out that the DC  
17       Circuit had said there's no assurance that  
18       reasonable accounting measures translate  
19       automatically into reasonable rates. I didn't  
20       hear the BN object to that proposition. They  
21       just ignored it. And that's the proposition  
22       that we're raising before the Board today.

1           We've also heard a lot about  
2 precedent. And it's interesting to me having  
3 sat through so many major merger proceedings  
4 where the railroads would come in, including  
5 the BN, UP SP, Conrail, and the pitch before  
6 this agency was, let us merge.

7           We'll have, costs will go down.  
8 Customers will be benefitted in the form of  
9 reduced rates and we improve service. That  
10 was the reason why all these mergers were,  
11 generally speaking, approved. And we think  
12 the same thing was true with the acquisition  
13 of CNW.

14           You can get into all the weeds about  
15 who said what one, who said what when, but  
16 that's what was going on in these  
17 transactions. And that's what the Board said  
18 in Conrail. I didn't bring the Conrail  
19 decision with me, but we quote it in our  
20 papers where the Board said that's exactly why  
21 we've approved all of these mergers.

22           And our position basically is, and

1       those mergers had premiums, this case is  
2       different. And if you believe that the Board  
3       in those cases was approving these mergers in  
4       order to basically help consumers by reducing  
5       rates and improving service, this is a  
6       different animal. And that's our argument on  
7       why precedent should be distinguished.

8               We've also heard a lot about the  
9       impact on the, you know, the rates and the  
10      jurisdictional threshold. In Mr. Crowley's  
11      rebuttal testimony we put in, you know,  
12      percentages based on what percentage of  
13      regulated traffic would be basically removed.

14             And unfortunately that's a highly  
15      confidential number, which is why we didn't  
16      cite it today. But it's significantly larger  
17      than the, whatever the 2 percent of all of  
18      BNSF's traffic which includes exempt traffic.

19             And if you look at the portion of  
20      the traffic that's regulated we have figures  
21      in there. We also have figures showing that  
22      a very large percentage, again it's highly

1 confidential, of BNSF's traffic base is  
2 subject to regulation by this Board because  
3 their rates are over 180 percent of variable  
4 costs.

5 We've also heard today and it's  
6 interesting to hear railroad, some of the  
7 railroad folks up here saying that, you know,  
8 URCS doesn't make, you know, any difference  
9 out in the commercial world. John Lannigan,  
10 who is one of the senior officials at BN,  
11 testified in this case, or actually in some  
12 other cases about how important URCS was.

13 Coal shippers and others are more  
14 sophisticated. If you're captive you go in  
15 and you try to negotiate a deal based upon  
16 URCS and other STB standards. And Mr.  
17 Lannigan has acknowledged that in other cases.  
18 And that's one of the reasons why the BN comes  
19 in here time and time again.

20 If your standards didn't make any  
21 difference, they wouldn't be in here talking  
22 about them. And, you know, I think another

1 point which came up which was the impact on  
2 SAC and things like that, I'll let Mr. Crowley  
3 address. Because we put quite a bit of  
4 material in here trying to demonstrate that it  
5 does have a substantial impact.

6 You know, not just on past SAC  
7 cases, but could on future SAC cases. And  
8 also it has a tremendous impact on your three  
9 benchmark cases which use RSAM and as you roll  
10 in the higher RSAM figures as a four year  
11 average, you not only have one year that has  
12 the premium in there because you roll that in  
13 and then also apply it to a marked up base  
14 variable cost figure, you're going to see  
15 substantially higher numbers in these small  
16 rate cases.

17 And so while we represent large  
18 shippers and we're concerned about the impacts  
19 on them, one of the more fundamental impacts  
20 of all this will be on the small shippers.  
21 And I mentioned at the outset if you have a  
22 case where you only have a million dollars

1       worth of relief, you're not going to be able  
2       to get in and start arguing the way we have  
3       here about removing the premium.

4               MR. CROWLEY: One of the things that  
5       we heard a lot this morning from the BNSF, was  
6       the words not a big impact. That was repeated  
7       over and over again and it was never followed  
8       by any numbers or quantification of what not  
9       a big impact means.

10              I won't go over the stuff that we  
11       presented already or that's included in the  
12       written evidence other than to say that we  
13       have numerous examples of the impact on the  
14       MMM process and the SAC and simplified SAC  
15       approaches. I would suggest that in  
16       simplified SAC you actually use URCS to make  
17       some calculations.

18              And then in the three benchmark  
19       cases we've shown examples of where virtually  
20       70 percent of the relief can be gone over the  
21       five-year period. One thing I'd like to  
22       mention or maybe remind the Board of is, when

1 the Board or the ICC I guess it was,  
2 transitioned from Rail Form A to URCS,  
3 probably haven't heard Rail Form A in a few  
4 years, they created a linking factor. Because  
5 they were concerned about the amount of  
6 regulated traffic that would go away by  
7 adopting URCS because it calculated costs  
8 slightly differently.

9 Now that's something that you could  
10 certainly implement here if you're in favor of  
11 such a linking factor. It would take care of  
12 at least the jurisdictional threshold side of  
13 the issue. The revenue adequacy side could be  
14 taken care of by a simple deduction to net  
15 investment. I think the solutions are  
16 relatively straightforward if you're buying  
17 our position.

18 MR. WILSON: What struck me in  
19 listening to the BNSF arguments was how much  
20 of what they had to say was, I think, beside  
21 the point that the Board should be focusing on  
22 in this case. What is the point? The point

1       seems to me is what are fair rates for captive  
2       shippers. The point is not market valuation  
3       or stock value. The point's not market forces  
4       setting prices.

5               Captive shippers don't have the  
6       benefit of market forces setting prices. And  
7       it's quite different for them than it is for  
8       apparently the bulk of railroad shippers. So  
9       what's fair about double compensation for  
10      inflation both through acquisition premiums  
11      and through nominal rates of return? It  
12      doesn't seem to me that that's reasonable or  
13      fair and regulars that I know would not  
14      tolerate that.

15              What's fair about providing captive  
16      customers less protection than is provided for  
17      customers that have the benefit of competitive  
18      protections? Regulation exists for the  
19      purpose of giving captive customers some of  
20      the protections that competition provides in  
21      competitive markets.

22              Competition would never permit

1 double compensation for inflation.  
2 Competitive markets wouldn't tolerate it.  
3 Competitive markets would never permit raising  
4 rates simply because of changes in ownership  
5 if there's no increase in benefits. If  
6 there's no increase in efficiency, if there's  
7 no reduction in costs, competitive markets  
8 wouldn't reward with higher prices.

9           So what is being suggested here by  
10 BNSF is not only inconsistent with what  
11 happens in competitive markets, that is the  
12 protections that are provided for captive  
13 shippers, but I think that an awful lot of the  
14 discussion, an awful lot of the argument has  
15 strayed very far from what the Board's central  
16 focus should be. And that's the protection to  
17 captive shippers.

18           CHAIRMAN ELLIOTT: Thank you. Vice  
19 Chairman.

20           VICE CHAIRMAN MULVEY: Thank you. A  
21 couple of brief questions. You mentioned  
22 about the size of the impact and I asked a

1 question and I didn't follow my notes. I  
2 asked about, they mentioned 2 percent and I  
3 said 2 percent of what?

4 Well the other part of that is 2  
5 percent of the regulated traffic or 2 percent  
6 of the total traffic? And you accurately  
7 mentioned it was 2 percent of the regulated  
8 traffic that is a lot greater percentage, a  
9 lot more of an impact.

10 But basically I think we hear from  
11 both sides that this is basically an all or  
12 nothing problem. Either we follow GAAP or we  
13 do not follow GAAP. And it was suggested that  
14 perhaps there was some way of phasing it in.  
15 And we didn't really get any warm and fuzzy  
16 responses to that from either side.

17 Your side basically said no. The  
18 other side basically said we'd rather not. So  
19 it does strike me that we are going to have to  
20 decide this either to accept the GAAP or to  
21 reject it and go to book value of the assets.  
22 Would you agree with that? That it's

1 basically one way or the other. Or could you  
2 see some way of splitting the baby?

3 MR. WILSON: I would suggest that  
4 you focus a little bit more than some of the  
5 arguments have suggested on what the purpose  
6 of the valuation is. I think there's no  
7 question that market value, the price that's  
8 paid for common stock is the best measure of  
9 the market value of common stock at that  
10 particular moment in time. And that's subject  
11 to change over time.

12 On the other hand, if you want the  
13 best measure of the investor's contribution of  
14 the investors, what the investor has dedicated  
15 to public service, certainly book value is  
16 very relevant. And that argument was made  
17 earlier that I think is absurd.

18 That somehow valuing on the basis of  
19 the present value of stock is somehow less  
20 risky to investors than guaranteeing them a  
21 return and a recovery of their capital,  
22 including an inflation allowance on the actual

1 investment that was made, the book value.  
2 That's, I don't know how much financing some  
3 of the other folks here have done, but  
4 certainly if you go to the investment  
5 community there's nothing that's lower risk  
6 than providing for the recovery of capital and  
7 a return on that capital that the investor has  
8 put up.

9 And that's not the present value of  
10 common stock. The present value of common  
11 stock to an economist is of course an  
12 important measure, but it's not necessarily  
13 the measure that ought to be used for this  
14 type of a regulatory determination.

15 MR. CROWLEY: Let me talk about the  
16 2 percent for just a second. The 2 percent  
17 that I calculated this morning was the impact  
18 on Western Fuels, what the base for their  
19 example. It wasn't an indication of how much  
20 traffic was impacted because of this  
21 transaction.

22 VICE CHAIRMAN MULVEY: I was

1       referring to their 2 percent, not your 2  
2       percent.

3               MR. CROWLEY:   Okay.   Thank you.

4               VICE CHAIRMAN MULVEY:   At the  
5       beginning I said there's two basic issues here  
6       to decide on the impact of this on rates  
7       versus also what is the theoretical, proper  
8       way of accounting, no pun intended.   Do you  
9       think the Board should focus on the impact or  
10      should it focus on the, what is the correct  
11      way of handling, the theoretically correct way  
12      of handling the purchase?

13              MR. CROWLEY:   I would think they  
14      would go hand in hand.   Hopefully they would.  
15      But obviously we have a, we're at a crossroads  
16      here.   How do you ignore the impact on a group  
17      of shippers?   I mean, how do you condone  
18      letting rates increase because of this  
19      transaction?

20              It just seems like it's very  
21      straightforward.   This is a very unique  
22      situation.   It's never happened before.   I

1       don't think you need to be, follow some strict  
2       set of conditions that happened where  
3       circumstances were different. I think you can  
4       handle this differently. And I think Mr.  
5       LeSeur has given you plenty of authority to do  
6       that.

7               VICE CHAIRMAN MULVEY: We have the  
8       authority to make a decision here one way or  
9       the other. I don't think we are precluded  
10      from going one way or the other and that's  
11      obviously something we'll have to be  
12      considering.

13             CHAIRMAN ELLIOTT: Just one last  
14      question. In Mr. LeSeur's reading of the law  
15      states that we're looking at these things on  
16      a case by case basis. And you mentioned this  
17      is a very unique circumstance.

18             And if we are looking at it on a  
19      case by case basis and we take in mind BNSF's  
20      consideration of consistency with respect to  
21      our regulation, it kind of brings me back to  
22      my idea of phasing in the premium with,

1 keeping in mind the comments made by Mr. Hund  
2 regarding time period and having a proper  
3 basis for it.

4 And that would seem like here maybe  
5 an ideal way to keep the consistency going and  
6 also deal with some of these equitable issues  
7 that you have raised today with respect to  
8 revenue adequacy and threshold. Now I don't  
9 know technically if all of this is possible.

10 But I wonder after hearing BNSF's  
11 warm embrace of my concept, for the record,  
12 that was a joke. But I would say begrudgingly  
13 acknowledging it, if you have any further  
14 thoughts on that?

15 MR. LESEUR: What do you mean by  
16 phasing it in? 25 percent of the year or  
17 something until it's all phased in, are we  
18 phasing it out? What are we doing?

19 CHAIRMAN ELLIOTT: No. We would be  
20 phasing it in.

21 MR. LESEUR: Phasing it in. Because  
22 it's already in there now so you would --

1                   CHAIRMAN ELLIOTT: Well, we're  
2                   acting as if we're starting from ground zero,  
3                   I guess.

4                   MR. LESEUR: Right. So under that  
5                   proposal you would have, assuming it's, the  
6                   write up is 8 billion, you'd have 2 billion in  
7                   year one, 4 billion in year two and you'd  
8                   phase it in that way?

9                   CHAIRMAN ELLIOTT: That would be the  
10                  general idea.

11                  MR. CROWLEY: So we take the 8  
12                  billion out and start from our base and put 2  
13                  billion in a year.

14                  MR. LESEUR: I don't see over the  
15                  long term how that would provide much  
16                  protection to captive shippers, particularly  
17                  dealing with the ten-year prescription you're  
18                  going to be using in URCS where you're phasing  
19                  it in. So I think that's why you haven't seen  
20                  a real warm and, if you're going to phase it  
21                  out. Since it's in right now, if you phase it  
22                  out over a four-year period then that might be

1 something that we would.

2 CHAIRMAN ELLIOTT: I've never heard  
3 that legal concept before. But --

4 MR. WILSON: I would think that if  
5 you're going to do something like a phase in  
6 it would be important that the phase in be  
7 capped by increases in rates in the  
8 competitive market so that captive shippers  
9 are not the only ones that are being stuck  
10 with the acquisition premium.

11 I think that anything that involves  
12 a phase in should certainly cap the phase into  
13 what is being seen on the competitive market  
14 side so that the captive shippers are not  
15 abandoned completely on this question of the  
16 double compensation and so on.

17 CHAIRMAN ELLIOTT: I have nothing  
18 further. Thank you all for coming today and  
19 being so patient working through all day  
20 without a break. That's greatly appreciated.  
21 And we'll take this matter under advisement  
22 and the meeting is now, the hearing is now

1       adjourned.   Thank you.

2                   (Whereupon, the hearing in the  
3       above-entitled matter was concluded at 2:33  
4       p.m.)

A				
<b>AAR</b> 60:3 139:1	67:3 71:7 177:4	223:1,2,3,13,20	<b>acknowledged</b>	210:3,9,19 211:4
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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Western Coal Traffic League  
Petition for Declaratory Order

Before: Surface Transportation Board

Date: 03-22-12

Place: Washington, DC

was duly recorded and accurately transcribed under  
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232132

# Finance Docket No. 35506: WCTL Petition

## Surface Transportation Board Public Hearing

March 22, 2012



# **BNSF Panel of Speakers**

- **Tom Hund, BNSF Executive Vice President and Chief Financial Officer**
- **Rick Weicher, BNSF Vice President and General Counsel – Regulatory**
- **Rob Jenkins, Mayer Brown LLP**
- **Prof. Roman Weil, Booth School of Business at University of Chicago**
- **Dr. Kevin Neels, The Brattle Group**

# Key Points

- **GAAP is the foundation of consistent financial reporting in US**
- **Purchase accounting is required by GAAP**
- **Purchase accounting adjusts historical book value to purchase price**
- **Berkshire Hathaway and BNSF appropriately applied purchase accounting**

## Key Points (cont'd.)

- Historic book value is not a better measure of assets than purchase accounting results
- Two thirds of write-up recorded to Goodwill that does not impact the regulatory base
- 100% of premium paid by Berkshire over market value of stock recorded to Goodwill

# Valuation Process

- **Role of Ernst & Young**
- **Audited by Deloitte & Touche**
- **Duplicative assets not considered**
- **Low point in economic cycle**

# Purchase Price Allocation

<b>BRK Acquisition Price</b>	<b>\$35B</b>
<b>BNSF Historical Book Value</b>	<b><u>-\$13B</u></b>
<b>Purchase Price in Excess of Historical Book Value</b>	<b>\$22B</b>

Source: Hund Verified Statement (BNSF Opening), p.6

# Purchase Price Allocation

<b>BRK Acquisition Price</b>	<b>\$35B</b>
<b>BNSF Historical Book Value</b>	<b><u>-\$13B</u></b>
<b>Purchase Price in Excess of Historical Book Value</b>	<b>\$22B</b>
<b>Net Assets Affecting BNSF Regulatory Costs</b>	<b>\$8B</b>
<b>Goodwill - No Affect on BNSF Regulatory Costs</b>	<b><u>\$14B</u></b>
<b>Total</b>	<b>\$22B</b>

Source: Hund Verified Statement (BNSF Opening), p.6

## Comparison of Book Value to Market Value to Berkshire Acquisition Price

	Historic Book Value
Per Share	\$38
Total Value (In Billions)	\$13

Source: Hund Verified Statement (BNSF Opening), p.8

# Comparison of Book Value to Market Value to Berkshire Acquisition Price

	Historic Book Value	BNI Stock Value Immediately Prior to Purchase Announcement
Per Share	\$38	\$76
Total Value (In Billions)	\$13	\$26
Premium over Book		\$13

Source: Hund Verified Statement (BNSF Opening), p.8

## Comparison of Book Value to Market Value to Berkshire Acquisition Price

	Historic Book Value	BNI Stock Value Immediately Prior to Purchase Announcement	BRK Acquisition
Per Share	\$38	\$76	\$100
Total Value (In Billions)	\$13	\$26	\$35
Premium over Book		\$13	\$22
BRK Premium over Market			\$9

Source: Hund Verified Statement (BNSF Opening), p.8

# Comparison of Book Value to Market Value to Berkshire Acquisition Price

	Historic Book Value	BNI Stock Value Immediately Prior to Purchase Announcement	BRK Acquisition
Per Share	\$38	\$76	\$100
Total Value (In Billions)	\$13	\$26	\$35
Premium over Book		\$13	\$22
BRK Premium over Market			\$9
Net Asset Write-up Impacting BNSF Ry. Regulatory Costs		\$8	
Goodwill <sup>1</sup> Implied by the Market		\$5	
Goodwill <sup>1</sup> Implied by BRK Premium over Market			\$9
Total Goodwill <sup>1</sup> Write-up			\$14

<sup>1</sup>Goodwill is \$15 billion of net liabilities not affecting BNSF Railway regulatory costs.

Source: Hund Verified Statement (BNSF Opening), p.8

# Goodwill

- **Goodwill is an intangible asset.**
- **Goodwill does not impact URCS or other STB regulatory frameworks.**
- **In the Berkshire/BNSF transaction, almost two-thirds of the premium paid over BNSF's asset book value went to Goodwill.**
- **That premium over book has no impact at all on BNSF's regulatory costs, transportation rates, or the Board's regulatory functions.**

# **BNSF Market Based Pricing**

- **BNSF sets rates based on market conditions**
- **Shipper groups ignore the broader commercial context in which BNSF prices its transportation services.**
  - **Majority of BNSF's rates are not regulated at all by the Board.**
- **BNSF establishes rates for STB regulated traffic the same as for other traffic - in accordance with market conditions**
- **Purchase accounting has a minimal impact on URCS and the Board's regulatory functions.**
- **A small change in the Board's regulatory costs would not effect the rates we charge.**

Source: Lanigan Verified Statement (BNSF Reply)

# Summary

- **Treat acquisitions consistently using GAAP**
- **Deal with the few transitional anomalies on a case-by-case basis to mitigate impacts of purchase accounting**
- **Leave the long standing practice in place**

# **Richard E. Weicher**

**Vice President and General Counsel – Regulatory**

# **PA Does Not Have a Meaningful Effect on Regulatory Remedies**

- **Full Stand Alone Cost (SAC) Rate Cases**
  - The regulator is comparing relative R/VCs only when SAC revenues exceed SAC costs.
  - In the Maximum Markup Methodology, the R/VCs of all the movements would similarly reflect the PA adjustment.
  - This would be the case for all such future cases.
- **Simplified SAC Cases**
  - Like Full SAC, results are driven by the relative elements of SAC.

# **PA Does Not Have a Meaningful Effect Regulatory Remedies**

- **3 Benchmark Small Rate Cases**
  - **Results reflect relative R/VCs of comparable group.**
  - **Even with RSAM, unlikely there would be any meaningful impact.**

## **PA Does Not Have a Meaningful Effect Regulatory Remedies**

- **180% R/VC Jurisdictional Threshold**
  - **Applies to all rate cases as a safety net driven by statute.**
  - **Few rates are even close to the threshold.**
  - **If a given rail rate were to be driven down to 180 R/VC, it should be on the most accurate costs.**

# Existing Prescriptions

- For existing R/VC prescribed rates that straddle the transaction, the Board could adopt a bridging mechanism to retain the original structure of those findings.
- A one-time linking factor could adjust a prior R/VC-based prescription.
- The change would not effect any prior prescriptions that do not use R/VCs calculated using MMM.

# Revenue Adequacy

- In 2010, BNSF was revenue inadequate, with or without purchase accounting adjustments.
- Over the past decade, BNSF has been found to exceed its cost of capital only once.
- Cost of capital, the economy, and the company's performance will determine whether BNSF is revenue adequate in future years.
- Effect of future revenue inadequacy is undefined.

# Robert M. Jenkins, III

Partner, Mayer Brown LLP

## Comparison to Other Acquisitions

Transaction	Percent Increase in Assets	Amount of Goodwill
Berkshire BNSF (2010)	39%	\$14 billion
CN and IC (2002)	288%	\$0
NS and Conrail (1999)	43%	\$0
CSXT and Conrail (1999)	41%	\$0
UP and SP (1997)	74%	\$0
BN and ATSF (1995)	72%	\$0
Blackstone CNW (1985)	16%	\$0

- In percentage terms, this transaction had a smaller impact on asset values than almost all prior transactions.
- No other transaction generated Goodwill.

Source: Baranowski/Fisher Verified Statement (BNSF Opening), p. 5; Historic R-1 Reports and 10Ks

## STB FINANCE DOCKET NO. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.,  
 NORFOLK SOUTHERN CORPORATION AND  
 NORFOLK SOUTHERN RAILWAY COMPANY  
 —CONTROL AND OPERATING LEASES/AGREEMENTS—  
 CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

Decision No. 89<sup>1</sup>

*Decided July 20, 1998*

“[Parties arguing for the use of predecessor cost] have asked us to change our basic accounting rules to disregard the increased valuation of the former Conrail assets based on their recent sales price when we make revenue adequacy and jurisdictional threshold determinations. That relief would be inappropriate, and will not be granted. The Board’s [USOA], adopted in conformity with [GAAP], requires that the former Conrail assets be valued based on their recent acquisition cost, not upon Conrail’s book value. Indeed, the ICC’s decision to follow the recommendations of the [RAPB] to use acquisition cost, not book value, in this precise context, supported by NITL and others, was judicially affirmed. *See Association of American Railroads v. ICC*, 978 F.2d 737 (D.C. Cir. 1992).”

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## STB FINANCE DOCKET NO. 33388

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 —CONTROL AND OPERATING LEASES/AGREEMENTS—  
 CONRAIL INC. AND CONSOLIDATED RAIL CORPORATION

Decision No. 89<sup>1</sup>


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*Decided July 20, 1998*


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The Board approves, with certain conditions: (1) the acquisition of control of Conrail Inc. and Consolidated Rail Corporation (collectively, Conrail) by (a) CSX Corporation and CSX Transportation, Inc. (collectively, CSX), and (b) Norfolk Southern Corporation and Norfolk Southern Railway Company.

“The statute specifically limits our rate regulation to situations where the rate exceeds 180% of the variable costs of service, and the statute also directs that we conduct our costing in accordance with GAAP to the maximum extent practicable. See 49 U.S.C. 10707(d)(1)(A) and 49 U.S.C. 11161 (accounting). The relief that protestants are requesting would seem to contravene these specific statutory directives.”

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## STB FINANCE DOCKET NO. 33388

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“[T]he statute dictates that our regulation overall should give railroads the opportunity to earn the current cost of capital on their investments in rail property. 49 U.S.C. 10101(3), 10701(d)(2), 10704(a)(2). . . . [C]arriers cannot attract and retain capital unless they are given the opportunity to be compensated for the real value of the property, not just the book value. . . . [T]he purchase price agreed to by these commercially sophisticated railroads represents by far the best evidence of the current market value of these properties.”

Assets Allocated To NYC .....	221
Assets Allocated To PRR .....	222
Allocated Assets: Other Aspects .....	224

**F.D. No. 35506: WCTL –  
Petition for Declaratory Order**

**Professor Roman L. Weil**  
**Booth School of Business of the University of Chicago**

## Roman L. Weil

V. Duane Rath Professor Emeritus of Accounting  
Booth School of Business, University of Chicago

- GAAP purchase accounting is almost universally used in this country for financial reporting, and is required by the SEC for both regulated and unregulated companies.
- The issue here is whether the STB should accept BNSF's use of GAAP purchase accounting, consistent with the STB's rules, for regulatory purposes – in particular, whether the STB should use “predecessor cost” instead of (current) acquisition cost to value BNSF's assets and liabilities for regulatory purposes.

## Roman L. Weil

V. Duane Rath Professor Emeritus of Accounting  
Booth School of Business, University of Chicago

- The STB's goal as an economic regulator should be practicably calculating economically accurate costs – costs that will lead to decisions that maximize the returns from using scarce resources.
- In pursuit of that goal, GAAP purchase accounting costs are preferable to “predecessor costs.”
- The claim that GAAP purchase accounting has no “economic substance” is wrong, if that claim means managers make the same decisions about future cash flows whether it bases them on predecessor costs or on current acquisition costs.

# *The Brattle Group*

**Dr. Kevin Neels**  
**Principal**

*The Brattle Group*

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## Analogies Drawn From other Regulated Industries Do Not Apply to Railroads

- The reasons why FERC regulation prohibits use of acquisition costs do not apply to the rail industry.
- Original cost regulation doesn't just protect rate payers; it also protects investors. Railroads have no such protection.
- In the rail industry, there is no "rate base" for rate regulation purposes. Rates are set by the railroads based on market conditions and the demand they perceive for their services.
- In the limited circumstances where the STB sets rates, it applies stand-alone cost, which is not based on the investment values in the railroad's books.

## Analogies Drawn From other Regulated Industries Do Not Apply to Railroads

- The “circularity” and “double-count” concerns that led FERC and other public utility regulators to exclude acquisition premiums under original cost regulation simply do not apply in rail markets.
- Original cost regulation is incompatible with prices set in competitive markets.
- There is no economically valid reason for the STB to prefer obsolete “predecessor cost” to current acquisition cost for revenue adequacy and regulatory costing purposes.

# Tom Hund – Conclusion

- All post Staggers rail mergers, and industry in general, apply GAAP purchase accounting in acquisition transactions.
- The Board should not depart from decades of its established, judicially affirmed, precedent.
- There is no defensible rationale for changing the general application of this precedent.
- It would be bad public policy to go to a world of ad hoc, exception-based departures from GAAP for railroad accounting and costing.

## **Conclusion (cont'd.)**

- **BNSF's policy and practice is to set rates based on market conditions, not regulatory costs.**
- **Only a minimum amount of regulated traffic is potentially affected, and only modestly (e.g., 5% average change in URCS).**
- **The Board has effective remedies available to address any transitional anomalies in existing cases or prescriptions, and should do so in those cases where justified.**



**BNSF®**

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March 23, 2012

**VIA HAND DELIVERY**

Ms. Cynthia Brown  
 Chief, Section of Administration  
 Office of Proceedings  
 Surface Transportation Board  
 395 E Street, S.W.  
 Washington, DC 20423-0111

Re: STB Finance Docket No. 35506, *Western Coal Traffic League –  
Petition for a Declaratory Order*

Dear Ms. Brown:

After discussions with Board staff, we are enclosing for filing in the above-referenced proceeding copies of the presentation slides used at the Board's March 22, 2012 hearing by Thomas D. Crowley in his testimony for the Western Coal Traffic League, American Public Power Association, Edison Electric Institute, National Association of Regulatory Utility Commissioners, National Rural Electric Cooperative Association, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. (collectively "Coal Shippers/NARUC").

Also, questions were raised by the Board at the hearing on the methodology and basis for developing the values of the assets and liabilities as determined by BNSF as contained in BNSF Railway Company's ("BNSF") 2010 Annual Report R-1. Counsel for Coal Shippers/NARUC informed the Board at the hearing that counsel for Coal Shippers/NARUC had requested this information from BNSF by letter dated October 12, 2011, but that counsel for BNSF had declined to provide it by letter dated October 17, 2011.

Please find enclosed copies of the parties' correspondence on this matter, which consist of a letter dated October 12, 2011 where counsel for Coal Shippers/NARUC requested "all workpapers showing the methodology and basis for

Ms. Cynthia Brown  
March 23, 2012  
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developing the 'fair values' of the assets and liabilities as determined by BNSF" and a response letter dated October 17, 2011 (excluding the Highly Confidential enclosures) where counsel for BNSF declined to provide this information, stating that "[t]he methodology for applying GAAP principles to value purchased assets is not at issue in this proceeding, either as WCTL framed the issue or as the Board delimited it."

Thank you for your attention to this matter.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John H. LeSeur".

John H. LeSeur  
An Attorney for Coal Shippers/NARUC

cc: Service List  
Enclosures

## **The Berkshire Hathaway Acquisition Premium Will Directly Lead To Higher Rates For BNSF Captive Shippers**

### **Impact On Jurisdictional Threshold**

1. The jurisdictional threshold for a hypothetical BNSF 1,200 mile grain shipment will increase by \$0.40 per ton.
2. The jurisdictional threshold for a hypothetical 1,000 mile BNSF coal shipment will increase by \$0.58 per ton.
3. Traffic eliminated from STB jurisdictional constitutes a significant portion of BNSF's total regulated traffic.

## **The Berkshire Hathaway Acquisition Premium Will Directly Lead To Higher Rates For BNSF Captive Shippers**

### **Impact On BNSF Shippers With Rate Prescriptions**

1. The maximum rates set by the SAC constraint will increase, e.g., WFA/Basin's transportation charges will increase by \$25.1 million over the remaining life of the STB's rate prescription period.
2. The maximum rates set at the jurisdictional threshold will increase, e.g., AEPCO's total transportation charges will increase between \$1.8 million and \$4.1 million over the remaining life of the STB's rate prescription period.
3. SSAC rate relief parallels the declines that SAC rate relief will experience.
4. Three-Benchmark rate relief can be reduced by over 50% in future rate cases.

## **The Berkshire Hathaway Acquisition Premium Will Directly Lead To Higher Rates For BNSF Captive Shippers**

### **Impact On Revenue Adequacy**

1. The STB calculated the 2010 industry cost of capital at 11.03%.
2. When the impact of the Berkshire Hathaway premium is excluded, BNSF's 2010 ROI equals 10.66%.
3. When the partial impact of the Berkshire Hathaway premium is included, BNSF's 2010 ROI equals 9.22%.
4. When the full impact of premium is included, the STB's 2010 BNSF ROI calculation falls from 9.22% to 8.05%.

## Unlike Prior Railroad Acquisitions, Berkshire Hathaway's Acquisition Of BNSF Will Produce No Synergies To Offset The Premium

	<u>Amount (Millions)</u>		
<u>Merger</u> (1)	<u>Projected Cost Synergies Per Year</u> (2)	<u>Acquisition Premium</u> <sup>1/</sup> (3)	<u>Years to Recover Premium</u> <sup>2/</sup> (4)
1. NS/CSXT-Conrail	\$1,000	\$3,671	3.7
2. UP-SP	\$659	\$2,729	4.1
3. BN-ATSF	\$453	\$1,423	3.1
4. Blackstone – CNW	\$102	\$90	0.9
5. Berkshire Hathaway – BNSF	\$0	\$8,100	~

<sup>1/</sup> Net premium included in URCS.

<sup>2/</sup> Column (3) ÷ Column (2).

## **While GAAP May Require Inclusion Of The Premium For Financial Reporting, Its Inclusion Is Not Required For Ratemaking Purposes**

“GAAP does not require the STB to use any accounting convention for its regulatory purposes.” (Weil Reply V.S. at 3)

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“GAAP is not primarily directed to regulation, and thus should not be relied on for ratemaking purposes.” (Verecchia Rebuttal V.S. at 2).

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“Pre-acquisition costs reflect economic value of assets devoted to public use while the valuation after the Berkshire acquisition reflects the new market value of those assets. The issue for the STB when developing variable costs for regulatory purposes cannot be resolved by an examination of which cost is most ‘accurate’ because both versions of the costs are ‘accurate.’ Instead, the STB must look at the purpose of the valuation and the impact on the shippers due to an artificial increase in costs. “ (Crowley/Fapp Rebuttal V.S. at 6)

## SLOVER &amp; LOFTUS LLP

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WRITER'S E-MAIL:

October 12, 2011

VIA EMAIL AND U.S. MAILRobert M. Jenkins, III  
Mayer Brown LLP  
1999 K Street, NW  
Washington, DC 20006Re: STB Finance Docket No. 35506, *Western Coal*  
*Traffic League – Petition for Declaratory Order*

Dear Robert:

Thank you for your October 4, 2011 response to our request for workpapers. Our workpaper requests sought all workpapers supporting “the development of” BNSF’s write-up and depreciation calculations as contained in specified schedules of BNSF’s 2010 Annual Report R-1 (“BNSF’s R-1”). While your response included spreadsheet data reflecting account values, missing from your response was additional information responsive to our request for workpapers supporting “the development of” those account values.

At this time, WCTL requests that BNSF provide the following workpapers specifically relating to the development of the values shown:

1. In BNSF’s R-1, BNSF states that “[u]nder the acquisition method, the new basis of accounting totaling \$42,919 million, was pushed down and allocated to the underlying tangible and intangible assets acquired and liabilities assumed based on their respective fair values, with the remainder of \$14,803 million allocated to goodwill (included in other assets).” (BNSF R-1, Schedule 200, note 1, page 9) (emphasis added). Please provide all workpapers showing the methodology and basis for developing the “fair values” of the assets and liabilities as determined by BNSF.

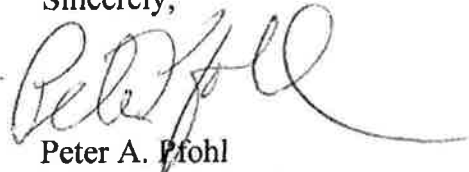
Robert M. Jenkins, III, Esq.  
October 12, 2011  
Page 2

2. The note incorporated in Schedule 330 of BNSF's R-1 states that the expenditures during the year for purchase of existing lines, reorganization, etc. "represents the purchase accounting fair valuation of assets net of the accumulated depreciation write-off due to acquisition of BNSF by Berkshire Hathaway." (BNSF R-1, Schedule 330, page 32) (emphasis added). Please provide all workpapers showing the methodology and basis for developing the "fair valuation" of the assets as determined by BNSF.

We request that these workpapers be provided no later than three business days from the date of this letter.

Please contact us if you have any questions.

Sincerely,

A handwritten signature in dark ink, appearing to read "Peter A. Pfohl", with a long, sweeping horizontal line extending to the right.

Peter A. Pfohl  
An Attorney for the  
Western Coal Traffic League

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October 17, 2011

BY E-MAIL AND FIRST-CLASS MAIL

Peter A. Pfohl  
Slover & Loftus LLP  
1224 Seventeenth Street, NW  
Washington, DC 20036

Re: STB Finance Docket No. 35506, Western Coal  
Traffic League—Petition for Declaratory Order

Dear Pete:

This responds to your supplemental request for workpapers, which you e-mailed to me on October 12, 2011. First, we cannot agree with your statement that there were workpapers “missing” from those that we sent you on October 4. Your petition for declaratory order seeks to have the entirety of the so-called “acquisition premium” deleted from BNSF’s URCS costs. As the Board put it in its September 26 decision initiating this proceeding, “WCTL asks the Board to declare that it will exclude the write-up in BNSF’s net investment base attributable to the difference between the book value and the price that Berkshire Hathaway Inc. (Berkshire) paid to acquire BNSF in 2010, and make corresponding changes in BNSF’s annual URCS depreciation calculations.” STB Decision at 1.

If the Board determined to adjust BNSF’s URCS costs as WCTL seeks, as you stated in your petition, it would be a “mechanical exercise . . . once all necessary data is collected.” Pet. at 5. As we understand it, in Attachment No. 4 to your petition for declaratory order, WCTL sought workpapers that would enable it to perform that “mechanical exercise.” That is what the workpapers we sent you on October 4 permit you to do. No other data are required.

It appears to us that your supplemental request for workpapers is really a request for discovery into a different question, which is how BNSF’s accountants applied GAAP principles to value the purchased assets. The methodology for applying GAAP principles to value purchased assets is not at issue in this proceeding, either as WCTL framed the issue or as the Board delimited it. Moreover, WCTL told the Board in its petition for declaratory order that no discovery was necessary in this proceeding, and the Office of Proceedings, in granting WCTL’s petition for protective order, expressly limited the scope of its order to the workpapers identified in your Attachment No. 4. Office of Proceedings Decision at 1-2.

As you note in your supplemental request, BNSF’s R-1 states that the amounts shown in the R-1 were based on the values determined in the purchase accounting process. BNSF is willing to provide workpapers showing those value amounts and how they relate to the asset

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categories in the R-1. Those workpapers are attached, and designated Highly Confidential. We do not believe that any additional discovery is warranted or permitted in this proceeding.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'RMJ', is positioned above the printed name.

Robert M. Jenkins III

cc: Jill K. Mulligan