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

A-P-P-E-A-R-A-N-C-E-S

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

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

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

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

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

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

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

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

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

So just so you know that and aren't doing anything funny while the cameras are on, because you will be viewed nationally. And I kind of prefer that we weren't having close ups either. But we can't get rid of that. Anyhow, we are waiting for Senator Franken to come. I heard he's going to be here momentarily.

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

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

VICE CHAIRMAN MULVEY: Is he here?

CHAIRMAN ELLIOTT: It's perfect timing.

SENATOR FRANKEN: Well, thank you.

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

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

I also want to thank you for being so flexible with your schedule and by allowing me to testify before your other witnesses this morning. I really appreciate that.

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

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

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

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

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

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

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

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

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

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

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

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

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

It isn't realistic for those farmers

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

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

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

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

I led a bi-partisan letter about

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

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

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

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

If this premium is included in the railroad's asset base, I fear it will send a message to the railroads that they can artificially inflate their assets to get around the Board's rules.

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

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

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

And it troubles me that the Board still considers BNSF to be revenue inadequate today. This is even after Warren Buffett has sent shareholder letters in 2011 and 2012 noting the strength of BNSF's financial performance over the last two years.

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

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

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

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

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

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

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

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

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

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

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

VICE CHAIRMAN MULVEY: Thank you, Dan.

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

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

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

And I must say that both sides of

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

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

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

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

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

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

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

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

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

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

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

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

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

We're joined by United States

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

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

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

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

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

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

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

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

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

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

And we believe that's particularly true when, you know, for electric utilities who are captive shippers and others, the folks that end up eventually paying the premium are utility rate payers, you know, farmers, small businesses.

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

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

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

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

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

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

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

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

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

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

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

And finally, BNSF repeats throughout its filings this case is really much ado about nothing. That in the end very few, if any, shippers will be adversely impacted by including the premium in BNSF's URCS and revenue adequacy rate base.

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

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

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

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

That's all I have for my opening statement. Mr. Crowley will follow this with details and then Dr. Wilson.

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

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

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

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

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

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

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

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

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

We also evaluated the number of BNSF

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

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

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

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

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

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

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

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

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

CHAIRMAN ELLIOTT: Mr. Crowley?

MR. CROWLEY: Yes?

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

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

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

MR. CROWLEY: Did I break the microphone?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GAAP does not mandate how rates are to be set because both the pre-acquisition costs and the new market value of assets are theoretically accurate.

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

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

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

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

I have participated in several hundred proceedings before FERC and state regulatory agencies involving public utility rates, competition, and service issues including many proceedings that address the regulatory treatment of acquisition premiums.

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

This morning, I would like to emphasize four of my principle conclusions. First, no public utility regulator, such as FERC or a state utility commission would permit a pass through of an acquisition premium on the facts in this case, which involves a very large acquisition premium and no offsetting consumer benefits.

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

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

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

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

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

Second, BNSF has argued that

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

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

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

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

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

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

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

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

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

PacifiCorp, and no circularity concerns were raised.

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

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

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

That is a standard similar to the one that FERC and state regulatory agencies have applied in permitting premium pass throughs when that has occurred.

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

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

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

These arguments have never been accepted by FERC or other public utility regulators in setting reasonable rates.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. WILSON: I'll take a crack at

that.

CHAIRMAN ELLIOTT: Sure.

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

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

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

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

The rate of return that's allowed is a nominal rate of return that includes both the real rate of return and the risk of inflation.

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

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

CHAIRMAN ELLIOTT: Okay, and back to the legal question. With respect to the precedent, you mention that all the other, or I assume all the other cases where we did end up marking up or marking down the assets, in those instances, especially where we marked up, there were synergies.

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

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

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

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

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

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

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

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

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

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

That is a typical synergy that you

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

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

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

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

MR. CROWLEY: Are you talking Blackstone now?

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

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

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

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

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

And if we addressed the situation in Western Fuels and Basin Electric, in that case itself, and dealt with it, and hypothetically that worked out to your liking, at that point, would you feel more comfortable with allowing us to write up the assets at that point?

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

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

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

And we believe that the proper way to approach it is to remove the premium from the BNSF's URCS for all purposes and for all cases, not just for these two shippers.

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

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

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

We're not asking the Board to change its accounting rules. We're just saying for purposes of the Board staff developing its URCS for BNSF and the Board staff developing the net investment base for revenue adequacy purposes, that the premium be removed.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. CROWLEY: I don't think so.

CHAIRMAN ELLIOTT: Okay.

MR. LESEUR: I'm not sure how many

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

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

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

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

And one of the folks that actually

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

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

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

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

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

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

CHAIRMAN ELLIOTT: Okay.

MR. LESEUR: Yes.

CHAIRMAN ELLIOTT: Vice Chairman?

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

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

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

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

You had a 1,200 mile grain shipment

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

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

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

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

VICE CHAIRMAN MULVEY: Okay.

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

VICE CHAIRMAN MULVEY: It can become

a big number when multiplied by a big enough number.

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

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

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

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

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

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

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

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

Would you think then, that would become an important part of the argument, if indeed, the cost, in fact, were greater than the two or three or four percent that's been estimated by WTCL and others?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. CROWLEY: Yes.

VICE CHAIRMAN MULVEY: Okay.

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

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

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

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

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

Here, the request to include the premium in only captive shippers rates is really a serious type of discrimination against captive shippers and treating them different than competitive market shippers, and certainly not what the regulatory process was set out to do, which was to replicate the effects of a competitive market where competition is absent.

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

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

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

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

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

MR. WILSON: Wow.

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

MR. WILSON: That would --

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

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

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

If we do that, shouldn't we lower

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

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

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

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

VICE CHAIRMAN MULVEY: Thank you.

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

MR. WILSON: I don't know the answer

to that question.

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

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

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

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

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

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

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

MR. WILSON: Yes.

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

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

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

They've paid for that increase in value because inflation is built into the rate of return that the utility or that the railroad has earned from rate regulated customers.

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

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

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

MR. WILSON: That would apply to the other carriers, too. To the extent that their rates are regulated, and to the extent that those regulated rates reflect a nominal cost of capital return, which as I understand, they do.

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

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

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

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

MR. CROWLEY: No.

MR. LESEUR: I would say, in answer to that, that in this case, we didn't challenge it. We did ask Burlington for it's work papers in how it calculated, basically, the increase in the value in the property accounts.

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

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

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

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

COMMISSIONER BEGEMAN: In response, again I think it was to the Chairman's question, when he was talking hypothetically as if the Board would go forward and allow the premium to remain in the asset base, he brought up the two rate prescription cases, both Western Fuels and AEPCO, that could be impacted here.

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

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

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

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

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

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

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

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

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

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

COMMISSIONER BEGEMAN: And then what will be my last question to you, again in the hypothetical. How would you propose, or could you propose, how the board should address AEPCO's rate prescription if the Board wanted to basically hold it harmless?

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

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

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

I mean, you know, as I understand it, how you pull the premium out of the URCS is a mechanical exercise. If you've seen some of Mr. Crowley's exhibits, you'll see there's a lot of steps that are involved.

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

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

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

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

And you get a SAC case and you get into how the MMM model works and things like that. But you can see in this one case the dollar impact of the two that are out there right now.

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

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

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

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

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

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

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

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

MR. CROWLEY: Let me just offer a

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

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

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

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

VICE CHAIRMAN MULVEY: Thank you.

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

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

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

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

Every year, you're going to calculate the variable cost and apply the MMM ratio. If your variable costs go up, and your MMM ratio, assume it stays the same, which it wont, but assume it does, you're still getting a higher prescribed rate then you were before the premium was included.

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

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

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

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

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

And if you include the premium in the URCS, the variable costs are going to go up. Mr. Crowley just says if you multiply it by the same MMM ratio, your rates are going to go up.

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

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

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

I think everybody agrees, if you put the premium into the URCS, the base variable cost numbers you're multiplying the MMM ratio against is going to increase.

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

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

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

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

And so when you talk about a SAC case, you know, the standard is, is the maximum rate the greater of SAC or the JT. And half of your cases since 1996, the large ones, JT has set the rate. And this, obviously, impacts the JT.

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

MR. LESEUR: Right.

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

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

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

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

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

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

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

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

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

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

CHAIRMAN ELLIOTT: It's quite fine.

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

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

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

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

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

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

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

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

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

We are also concerned that in the future, more premiums are quite possible that it could affect other railroads, ultimately effecting competition and rail rates of all agricultural shippers.

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

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

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

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

This investment reflects the

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

When we experienced low prices

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

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

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

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

CHAIRMAN ELLIOTT: Thank you, Mr. Hurst.

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

Chairman Elliott and Vice Chair

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

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

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

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

But contrary to the BN's arguments,

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

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

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

CHAIRMAN ELLIOTT: It's a common problem.

MR. WHITESIDE: Pardon me?

CHAIRMAN ELLIOTT: It's a common problem.

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

VICE CHAIRMAN MULVEY: There's that little thing on the side. You pull that up and then you sit up and then it will go up again. But you have to sit up when you do it.

CHAIRMAN ELLIOTT: You have to sit up.

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

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

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

Ag shippers from farm producers rule

economies are particularly vulnerable. Montana is the most captive state in the Union from a rail standpoint with BNSF controlling over 90 percent of the rail.

North Dakota's not much better. Both states are too far from export facilities in the Pacific Northwest for trucking to be viable.

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

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

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

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

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

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

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

Let me talk a little bit about BN's attempt to wrap itself in the flags of GAAP and precedent: but Berkshire Hathaway, which actually paid the acquisition premium for which the BN seeks to benefit has not supported BN's position in this proceeding.

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

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

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

Also, the Board needs to consider where the public interest lies. Is it served by facilitating more unchallengeable rate increases by the BN at a time when the BN has shown that it's ready, willing, and able to raise rates even without an $8 billion write up, or is the public interest better served by the decision which sets forth the acquisition is different from past acquisitions and which gives a small boost to the bargaining leverage of captive shippers of agriculture and other commodities. Thank you, and I'll turn this over to John.

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

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

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

I'm referring to Page 6, Footnote 10 citing BNSF witness Lannigan as follows, I'm quoting, "In very limited instances, we might look at the RVC level of a specific rate, such as when a customer calls it to our attention in a negotiation, or the even rarer instances where there appears to be a risk that we might be involved in rate reasonableness litigation."

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

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

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

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

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

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

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

You suggested that those might be dealt with ad hoc in the individual decisions, but there are also an awful lot of shippers out there who figure that the odds against them are too high if they challenge a rate at 185 percent of variable cost.

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

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

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

It's never been applied. We've all thought about how great it would be if the railroad industry, or BNSF in this case, achieved revenue adequacy such that further differential pricing would have to be justified by BNSF.

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

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

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

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

But the way that the $8 billion

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

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

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

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

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

CHAIRMAN ELLIOTT: Thank you. Mr.

McBride?

MR. MCBRIDE: Thank you Mr. Chairman, members of the Board. I am Michael McBride. I am here this morning on behalf of CURE.

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

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

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

The Board's predecessor, the ICC, when it adopted URCS and all of this is cited at Page 8 of my opening comments for The National Corn Growers Association, held that it was not bound by accounting standards, and that it had so held in the productivity decision which is cited at that page of my comments.

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

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

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

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

So I think it is absolutely clear

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

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

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

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

The Conrail transaction as approved at that time by the Board was structured as a lease. The assets were kept on the Conrail books for the most part.

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

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

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

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

You asked about synergies, and I

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

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

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

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

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

This case is fundamentally different. BNSF is no different today then it was before the acquisition of Berkshire Hathaway. There are no synergies.

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

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

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

Well, by process of elimination, the only reason we're here is because Berkshire Hathaway's premium is being included in BNSF's costs, even though BNSF didn't bear those costs, so that captive shippers will pay more.

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

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

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

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

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

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

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

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

BNSF's witnesses Colby and Neels, by the way, candidly conceded. Now these are eminent regulatory economists. They believe in acquisition premiums because they believe in fair market value.

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

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

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

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

So you not only had the unknown of the fair value, but you had a second unknown, which was the real instead of the nominal cost of capital.

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

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

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

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

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

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

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

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

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

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

In fact, in it's written testimony,

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

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

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

I cannot imagine, although Commissioner Begeman was there and I wasn't, but I cannot imagine that Congress ever thought that the jurisdictional threshold of 180 percent set by law could be manipulated, if you'll forgive the pejorative, adjusted if you prefer, by the actions of a financial holding company paying an arbitrary premium and adjusting the jurisdiction of the Board by its own actions without the Board even having had the authority to approve the transaction.

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

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

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

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

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

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

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

MR. MCBRIDE: If I understand your question correctly, at the end of all those adjustments and calculations that Mr. Leseur and Mr. Crowley talked about earlier, Basin was prescribed a rate about 240 to low 240's depending on the year. And, you know, we don't have to quibble about the exact number.

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

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

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

VICE CHAIRMAN MULVEY: Well, that's what I was saying. That, in fact, the Board could act to offset that by changing the revenue and variable cost ratio so that they received the same absolute dollar benefit.

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

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

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

And if you hold that your hands are tied, or that we're only going to protect the shipper who happened to have gotten through the door before the monopolist or the holding company comes in here, you know, with an even larger premium, God help us because everybody else in America will not get the relief that was intended when Grover Cleveland signed that statute.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Those kind of things could generally be associated with transportation. The other thing to remember is that in a large number of cases, some of our suppliers are running into trouble.

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

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

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

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

But for most of our careers, I've farmed for over 30 years full time, and most of the time my margins were very, very slim, and transportation costs, the excess that I figured definitely effected my bottom line and my ability to survive, I and my neighbors. So it's a cumulative effect.

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

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

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

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

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

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

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

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

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

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

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

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

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

BNSF makes more money either way. The relief we're asking for doesn't tie BNSF's hands at all. All it does is give shippers who are so inclined a shot at negotiating better rates as a private sector solution.

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

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

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

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

And despite the fact that they got

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

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

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

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

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

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

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

CHAIRMAN ELLIOTT: Commissioner?

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

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

Number two, we have testimony from BNSF's CFO, Mr. Hund, who testifies that there was no in-house expertise in terms of determining how much of this premium that was paid should be allocated to assets and how much to good will and to which assets?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

That's saying something, since he's

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

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

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

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

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

Hope. You generally use book values.

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

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

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

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

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

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

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

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

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

And that kind of drives how they set the rate to a large degree. But yet it's kind of like, I see it as the regulatory environment, and Mr. Buffett looked at it, just like you would on a long open highway in the U.S. is marked speed limit 55.

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

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

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

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

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

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

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

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

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

The problem is that when they fall

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

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

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

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

COMMISSIONER BEGEMAN: Right, so fewer will be captive.

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

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

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

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

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

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

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

The feeling was always, well, you

know, 200 percent, 210 percent, 220 percent. That's where you're starting to talk about pain thresholds, rising to the level of let's sit down and talk to the railroad about the RVC levels and about the fact that we may be forced to file a challenge of the STB.

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

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

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

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

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

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

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

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

They'll say that we need to reinvest money and provide you with the service that you need. And so it takes so much to do that. And so that's why they raise their rates.

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

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

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

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

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

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

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

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

And there's no showing in my estimation that $23 billion was, other than an arbitrary amount that was arrived at by Mr. Buffett because he didn't want to argue with Mr. Rose about what he was going to pay for the stock, because it was still worth it to him.

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

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

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

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

But no, I'm not going to tell you that I think $23 billion is an accurate measure of anything besides what Mr. Buffett was willing to pay.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MR. MCBRIDE: Smyth v. Ames, it was

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

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

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

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

For the investor owned electric utility community and the others that I have represented, we have always argued for book values. We sat out that case that I just referred to and other shipper groups supported the Board's use of the lower values, the time.

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

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

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

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

I have been consistent, my clients, much more importantly to me, have been consistent on this for over 30 years. We've advocated for book value just as we do today. And no premiums.

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

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

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

I mean, NIT League seems to include

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

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

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

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

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

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

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

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

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

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

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

Board.

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

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

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

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

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

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

CHAIRMAN ELLIOTT: Okay. Last

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

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

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

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

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

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

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

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

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

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

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

Crowley laid out all his transactions and all the numbers.

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

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

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

So what's really changed is two things. Number one, the consolidations and the increased market power. Number two leading directly to the fact that the assets were now worth more than the book values rather than less.

I submit to you that's an entirely different situation then the case where the assets may have been worth less, because what the Supreme Court held on the Market Street Railway case a year after Hope was that a regulated entity was not guaranteed the recovery of its investment in the enterprise.

It's only a guaranteed an opportunity to earn a fair return on the investment in the enterprise. That's all the constitution required.

But the railroad saw that with the consolidations and the increased market power and growth of the economy, and the spectacular increase in the use of coal, which frankly was a third factor that fueled the revival, particularly the Western railroads out of the Powder River Basin, that this situation was ripe for the payment of large premiums.

If the Board would allow them to be passed through, even better. If it didn't, they were still worth the payment of the premiums. So that's what's changed.

You're suddenly now dealing with a situation where for 20 years we've been looking at premiums.

And the railroads are arguing that this one case where the Board, the ICC, said we'll use the lower value because that's what you paid for it, and the court of appeals simply deferred to the Board's use of that accounting methodology as a matter within it's expertise, not that it was required to do that, somehow necessarily entitles them to include any amount of a premium in any transaction that they pay, even one that you don't have to approve, as here?

I don't think that that's what happened back then, but that's what's changed since that time.

MR. HURST: If I could just say, you

know, from a farmer perspective, the last number of years we've had railroads going bankrupt and struggling.

And we're also, at the same time, we're experiencing for decades very low commodity prices and we understood hard times, frankly.

And we now see, though, that the railroads obviously can attract capital and stability. In fact, a lot of us said hey, that's great.

If a company like Berkshire Hathaway would acquire the BN, that's great. That's a sign of strength and stability and security.

But it's kind of also like if a wealthy land owner, and they do this out west, if they were to come in from another part of the country and buy ground that I was renting, and pay well over the market price of that ground.

But then say okay, as a renter, they're my new landlord, you're required to, you know, your rent's going to reflect what I paid for that ground, that's going to be a pretty tough situation.

That's going to drive me out of business, basically. But as far as we're concerned, you know, it's, I think a good sign that outside investors are investing and actually paying more than market value for the railroads. That's okay.

But then, you know, don't make us have to pay for that extra.

CHAIRMAN ELLIOTT: Vice Chairman?

VICE CHAIRMAN MULVEY: Yes. I have a couple of small questions. One, Mr. McBride's point, I believe you referred to Warren Buffett as the richest man in America?

Last time I looked at Forbes, I think he's number two, but he's close.

MR. MCBRIDE: I was saying no, if the richest man in America comes in here next, I'm worried about what Mr. Gates might buy.

VICE CHAIRMAN MULVEY: Oh, okay.

What Gates is going to do. I got you. I thought you referred to him.

This gets to the idea that --

CHAIRMAN ELLIOTT: He does play bridge with Mr. Buffett, you know. They can talk.

VICE CHAIRMAN MULVEY: I know. And you talked about how they arrived at the amount of the premium and that this seems to be a black box.

If we had a smoking gun that we could see that indeed there was an agreement in order to take advantage of circularity, which is sometimes charged in the utility cases, that that's why it is done.

But we don't have a smoking gun here. What do we presume? You suggested that everyone in America basically assumes that this was not done at arms length.

But we don't have any evidence that, indeed, there was anything untoward about this premium and about this decision on Mr.

Buffett's part save what I would presume to be a well thought out decision by him and his advisors to make this acquisition.

So do you want to comment on that?

MR. MCBRIDE: Yes, thank you very much. First of all, I have not ever, I hope, said this morning or at any other time, that there was anything untoward here. I'm not saying that.

There's nothing illegal, there's nothing underhanded. This was a transaction that Mr. Buffett was freely entitled to engage in.

And the BNSF's Board, as I understand it, looked at the price, as they were required to do for shareholders, and determined that it was a good price for shareholders. Nothing untoward, okay?

When I say that it wasn't arms length, that doesn't mean there was anything untoward. What that simply means is, it's like between a husband and a wife. That's not an arms length transaction. They're in business together, if you will.

And similarly here, Mr. Buffett was the largest shareholder, I believe. At least owned more than 20 percent of BNSF at the time he went to see Mr. Rose.

He didn't buy 100 percent of the shares at that time, he bought the remaining shares at that time. So by definition, is my point, it was not an arms length transaction.

He's the largest shareholder, the second richest man in America, and the man who may have the greatest financial ability in America coming to see Mr. Rose.

I don't think that that, just objectively, is an arms length transaction. And we know that happened.

And we know it was a very short conversation from what I've been told by reporters who were told this directly by those who were there. That it was 15 minutes and ten minutes of them were spent talking about automobiles, I think.

And the share price took about five minutes. Mr. Buffett, as I'm led to believe, this is how he does business.

He chooses a price, he does it intelligently, he know's what's going on. He knows the railroad's regulated, but only partially so because he's a shareholder and he's smart and he already owns Mid-American at this point, which moves coal on the railroad.

He knows, as you well know, he said that his buy of BNSF was a bet on the future of America.

So we know Mr. Buffett knows a lot about the railroad industry, how it's regulated, about the country, about the economy, about our dependence on railroads.

And he goes to see Mr. Rose and he does what he apparently always does in these circumstances. He says I'll pay you $100 a share. I don't want to argue about it.

I'm then told that after that, the

BNSF board evaluated it, as I indicated to you earlier, tried to get a little more out of it, as any good negotiator would try to do, and apparently Mr. Buffett said no. And then they took the offer.

That, to me, is as far removed from an arms length transaction as you could have. Nothing untoward, it was a fair value to him, presumably. It was a fair value to the shareholders.

The people that weren't in the room are the regulated customers. And the other people that weren't in the room were you. And they never came to you to approve that transaction because they didn't have to.

Again, there was nothing untoward about that. This is the first chance we get and you get to look at that transaction, look at what was paid, and decide whether it was fair, accurate and reasonable under the rail transportation policy.

I don't have to prove anything

untoward happened. I'm simply suggesting to you that, you know, nobody who had the customer's interests in mind was there determining the appropriate amount of the premium. That's all.

MR. CUTLER: Let me return to the asymmetry point I made earlier, too. We have no indication, and in fact to all appearances, the vulnerability of captive shippers to acquisition premium write ups was not on Warren Buffett's mind when he acquired BNSF.

That didn't drive this transaction. And we don't think that if you decided this case in shippers favor, it would discourage future acquisitions of other railroads.

The railroad industry as a whole has an extremely bright future for all sorts of reasons.

And the likelihood of the railroad industry being able to attract capital, even if the BNSF does not benefit from a write up as a result of your decision in this proceeding, that doesn't change.

On the other hand, there is an asymmetry in the sense that if the BNSF is allowed to write up its URCS costs and collect much of the acquisition premium from captive shippers who really aren't going to be able to fight back very hard, that sends a signal of an entirely different order to anybody who might be considering a future acquisition of a similar railroad.

Oh boy, other people's money. That makes this deal even more attractive than we thought.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN ELLIOTT: Thank you very much for coming today, and we really appreciate you taking that time.

MR. MCBRIDE: Thank you very much.

CHAIRMAN ELLIOTT: We'll call the next panel up.

VICE CHAIRMAN MULVEY: Is there anybody left running the railroad? Are we short one card there? You're free to edit the cards, obviously.

Do you have any particular order you want to go in?

MR. HUND: I think we're in it.

VICE CHAIRMAN MULVEY: Okay, then. The chairman will be back in a second, but we can begin now. Thank you. You can start.

MR. HUND: You would like us to start?

VICE CHAIRMAN MULVEY: Yes.

MR. HUND: Okay, great. Well good morning. I'm Tom Hund, Chief Financial Officer of BNSF Railway, and I've been with the company for 29 years, all on the financial side. I've been CFO since 1999, and prior to becoming CFO I was Controller of BNSF Railway and Sante Fe Railway for a decade.

And prior to that I worked for a big four public accounting firm. And by the way, it was not the one we engaged to help us with the evaluation work. I'm also a CPA. And I'm pleased to appear before the Board to discuss with you the appropriateness and application of purchase accounting under generally accepted accounting principles or GAAP, in this transaction that resulted from Berkshire Hathaway's acquisition of BNSF.

And so the Board scheduled this hearing to review the issues related to the treatment and the Uniform Rail Costing System or URCS and the revenue adequacy determination of BNSF's 2010 acquisition by Berkshire Hathaway. As the Board is aware, it's well stated, well settled that in every acquisition of a railroad by another entity over the past 20 plus years, the Board and the ICC before it have required that URCS reflect the post acquisition cost of the acquired railroad.

A few shippers have petitioned the Board to alter this longstanding adherence to GAAP accounting rules and the Interstate Commerce Commission's Act mandate to use the most accurate financial information available, because those shippers believe they can gain a modest regulatory advantage. BNSF disagrees that any change is necessary, and we will present compelling reasons for the Board to reject any change to this longstanding approach.

First, I'll be describing the method and results of the application of GAAP purchase accounting to this transaction and how the transaction has not changed the manner in which BNSF sets our market-based transportation rates. And I'm joined on this panel by my colleague, Mr. Weicher, who will describe in more detail the minimal impact that purchase accounting may have on the Board's regulatory functions and on BNSF's rate prescriptions.

Then Mr. Jenkins will outline how the Board and the ICC have consistently applied acquisition cost in every major merger or acquisition transaction in the last two decades. Professor Weil will discuss how fair value determined by GAAP is superior to out of date predecessor cost and how the agency's goal should be practicable application of economically accurate costs.

And finally, Dr. Neels will address how shipper concerns regarding the use of purchase accounting in the regulation of other industries by different agencies do not apply here. I'll then conclude. Now additionally, Mr. Baranowski, of FTI is here to answer any questions related to his prior submitted testimony.

So while much has been argued in this case, there are several things shipper groups and BNSF agree on, or at least no one has objected to and I've outlined them here. First, no one has disputed that generally accepted accounting principles or GAAP as set and enforced the SEC and the Financial Accounting Standards Board, provide the foundation for consistent financial reporting in the United States and that publically traded and other regulated companies such as BNSF are required to report their financial information applying these principles.

Additionally, we all agree that purchase accounting, which is basically adjusting the historic book value of an acquired entity's assets and liabilities to the purchase price paid for that entity, is required by GAAP. And that BNSF Railway and Berkshire Hathaway appropriately applied and followed GAAP in this transaction.

Purchase accounting is also part of the well-established standards and regulations of the STB, which is why our application of purchase accounting in this transaction is no different from what's been done in all other major rail transactions. And in fact the Board, the ICC, the Railroad Accounting Principles Board and the courts have repeatedly reaffirmed over more than two decades, that purchase accounting is appropriate.

Now let's look at a few other key points. Some parties to this proceeding would have you believe that historic book value represents the sum of original purchase prices paid for each asset. It does not.

Historic book value is an accumulation of asset values acquired over many years and by many different transactions. Some of these assets, like locomotives, we did purchase. We built others, like track and bridges, and many others were the results of prior mergers and acquisitions of entire companies.

Our company is over 150 years old and the result of several hundred mergers and acquisitions. And purchase accounting provides the most economically accurate measure of our assets and liabilities.

Now two additional points are important to keep in mind. And they are that two thirds of the write up, meaning the amount Berkshire paid for which, for BNSF in excess of our historic book value was recorded to good will, which does not impact the regulatory cost. And that 100 percent of the premium, and the premium here I mean as the amount that Berkshire paid over the market value of BNSF stock, went to good will. And I'm going to give specific details on this in a moment.

But first let me briefly review the process we went through to calculate the purchase accounting adjustments. The process started with determining the fair value of our assets and liabilities. And because we didn't have the necessary expertise in the various valuation techniques, Berkshire Hathaway hired Ernst & Young, a big four accounting firm, to assist us. And note that I said assist.

And at the end of the day, myself, Matt Rose, Mark Hamburg the CFO of Berkshire Hathaway and Warren Buffett its Chairman, had to sign our 10K's as to the appropriateness of our financial statements. And those financial statements included purchase accounting. So clearly this is an assist, not a complete determination.

And also we've discussed the, I'll say, our methodology of purchase accounting with the STB's accounting staff and I'm not aware of any unanswered questions from your staff at this point. And then finally, as part of the audit at year end, our financial statements are audited by Deloitte & Touche and they also agreed with the application of purchase accounting.

Now Ernst & Young's activities included reviewing the physical condition of hard assets and looking for synergistic opportunities with regard to the overall network of assets. And as I just mentioned, since our railroad dates back more than 150 years and is the result of many mergers and acquisitions, the assemblage of our network contains some amount of duplicative routes.

In the evaluation process we

assessed an optimized network where only the productive capacity of the railroad was considered in establishing the new net book value for the property, plant and equipment. This resulted in not only the write up of some assets, but also the write down of some assets that are and including assigning no value to more than 6,600 route miles which represents about 30 percent of our network.

It's also important to note that this assessment was conducted as of the transaction closing date, which was February 12, 2010, which was a low point in the economic cycle, which further reduced the amount written to hard assets. And as an example, some locomotives were written down because they were determined to be excessive on the acquisition date, but that might not be the case today.

Let's take a look at the numbers for a moment. Let's look at purchase accounting at a high level and what impacts regulatory cost and what does not. Here you see that Berkshire Hathaway paid a total of $35 billion for BNSF. Our historic net book value, which is a historic value of assets less liabilities on the acquisition date, was $13 billion.

In applying purchase accounting, this left $22 billion of the acquisition purchase price to be allocated to the fair value of our assets and liabilities with any excess recorded to an intangible asset called good will. In this transaction as a result of the thorough evaluation I just described, only $8 billion of the purchase price in excess of book value was allocated to BNSF's net assets and $14 billion was recorded to good will.

And there is agreement that this significant portion of the purchase price does not impact the regulatory process. And the $14 billion is larger in both terms of dollar and percentage than amounts recorded to good will in all other railroad transactions.

I'm now going to dive a little

deeper into the numbers. And for those of you who perhaps aren't into the numbers as much as the CFO, I'm also going to summarize the points at the end because the next couple slides get a little mathematical.

We're going to walk through the purchase accounting step by step using some of the same numbers I just used, but compare it to the historic book value and to the market value just before the Berkshire acquisition was announced and to what Berkshire paid. So let's start with BNSF's historic book value was $13 billion, or $38 per share.

Well the market value immediately prior to the announcement of the acquisition was $26 billion or $76 a share. So this represents a market premium over historic book value of BNSF of $13 billion. So said in another way, said simply, before the Berkshire deal was announced, the free market said that BNSF was worth about twice its historic book value.

Now Berkshire paid over $100 per share, $35 billion, which was about a 31 percent premium. And that premium in the aggregate was about 22 billion over historic book value and 9 billion over total market value of BNSF immediately prior to the purchase announcement.

Let's talk briefly about that $100 per share and Mr. McBride's comments. First of all, two investment bankers issued fairness opinions to the BNSF Board and all of that's described in our public proxy statement.

But secondly, and I believe more importantly, 95 percent, I'm sorry over 95 percent, I think the number was 98 percent of all shareholders who voted on the transaction of whether they should accept the $100 or not, voted to accept the $100. So we had almost unanimous agreement of our shareholder base and not just our Board of Directors, that this was an appropriate value for the company.

Only 8 billion of the 22 billion

total premium over historic book value was allocated to the assets and liabilities that impacted regulatory costs while the remaining 14 billion was attributed to good will. And Berkshire paid 9 billion more than the market value of BNSF. So you can see that 5 billion of good will was already implied in BNSF's market value prior to the Berkshire purchase.

So the purchase price paid for the railroad was driven by market, but the 8 billion in added net asset value was determined by a different method. And that method was the thorough evaluation process required by GAAP and performed with the assistance of Ernst & Young that I described earlier.

Let's talk about the split between good will and other assets and why that matters. Good will is an intangible asset that doesn't affect URCS regulatory cost. As I just demonstrated, the portion of the write up went to net assets and reflected in URCS in revenue adequacy determinations was already reflected in our stock price prior to the acquisition. Every dollar of the premium Berkshire paid over the market value of stock went directly to good will, which again has no impact on the regulatory framework.

Now some would have you believe that Berkshire paid a significant premium in hopes of recouping that premium through increasing rates on regulated traffic. Now that's not correct. Because even if Berkshire had gotten another offer two weeks after their agreement with us to sell BNSF for $150 a share to another buyer, there would have been no change to the $8 billion write up.

So all of this shows that Mr. McBride's accusation that Berkshire manipulated the system is incorrect. Some shipper groups also contend that allowing purchase accounting will give BNSF the ability to significantly raise rates to its customers.

And they contend that if BNSF URCS

cost increase because of the application of purchase accounting, some rates that are now subject to rate regulation would fall below the jurisdictional threshold. I do not agree that rates will increase because of this transaction. BNSF's policy and practice is to set rates based on market conditions and market demands for its services, not cost.

A significant portion of BNSF's rates are not regulated by the Board. BNSF competes vigorously for this business and as a result its rail rates must be determined based upon market forces. BNSF establishes rates for traffic that is subject to regulation in the same way, based upon market conditions, not based upon regulatory cost.

Also a small change in the Board's regulatory cost would not affect the rates we charge. BNSF does not set rates on our traffic based on where it falls in relation to the jurisdictional thresholds. We estimate that out of 9 million revenue moves in 2010 involving thousands of shippers, less than 2 percent of regulated movements would move from above to below the Board's jurisdictional thresholds.

And using a different bottoms up approach, Western Coal traffic league's expert witness statement confirmed that the impact was limited to less than 2 percent of BNSF's 2010 movements. And for even this handful of shipments the practical impact of this shift would be negligible, as few shippers ever bring a rate case and even fewer are brought that challenge the rate at or near the jurisdictional thresholds.

And Mr. Weicher is going to go into more details about the impact of purchase accounting on rate regulation. But finally, as evidence to BNSF's market-based pricing, we've all read recent articles discussing Class 1 railroad's reaction and impact, reaction to the impact rather, on coal demand due to mild winter weather and low natural gas prices. And I can tell you that in certain circumstances BNSF has reduced coal rates reflecting these changed market conditions, including for some solely served utilities.

Let me conclude by saying that GAAP is the gold standard of financial reporting and is required by the SEC. To make us use a different method of accounting for STB purposes would require us to keep two sets of books. A less onerous solution would be to deal with the limited instances where rates may be impacted rather than changing the reporting standard.

Specifically, we do have two unique situations and those are Western Fuel and AEPCO, where the Board prescribed a rate at the end of a stand alone case using R/VC ratios based upon URCS cost prior to the Berkshire acquisition. In these unique situations the purchase accounting adjustment may alter BNSF's URCS cost for regulatory purposes and create a modest effect on the rates and those R/VC ratios that they translate into.

These two unique cases have nothing to do with the rate sets BNSF sets for the other shippers or for our rates that BNSF will be able to set for markets for services going forward. These unique cases can be addressed in the context of those specific proceedings which remain open before the Board.

So in conclusion, the Board should not break from over two decades of precedent and change its policy on the application of purchase accounting, which is governed by very specific accounting rules that are universally accepted in the United States.

MR. WEICHER: Good morning. Thank you Chairman Elliott, Vice Chairman Mulvey and Commissioner Begeman for the opportunity to appear. My name is Rick Weicher, Vice President and General Counsel Regulatory of BNSF Railway. I've been with the company for over 35 years as a member of the legal department. I've worked extensively in the areas of regulatory practice transactions and administrative litigation before the Surface Transportation Board and its predecessor agency.

I appreciate the opportunity to address these issues arising from the Berkshire acquisition of BNSF. I will describe the effects of the accounting treatment Tom Hund has reviewed in several areas of STB specific regulation. The Board's methodologies in rate cases that come before it, regulatory costing under URCS and in connection with existing prescriptions and then the area of revenue adequacy.

And overall why the application of GAAP purchase accounting has a minimal to limited impact on the access to remedies before this agency and their application by this agency. First in the Board's rate remedies and rate procedures I'll address the stand alone cost major rate case. It's constrained market pricing approach.

I should say I think there is a theme in the Board's regulatory methodologies adopted in the last few years, which does involve revenue varied costs, R/VCs. But it compares them as part of its standards in all sizes of rate cases. And I think that's an important distinction.

Okay. Stand alone cost major rate cases, we've heard from coal shipper organizations this morning. I think the first determination that is made by the Board in a stand alone rate case, is whether stand alone revenues of the hypothetical stand alone railroad, the highly litigated hypothetical stand alone railroad, exceeds stand alone costs.

But those aren't based on URCS. They are based on the cost developed for this hypothetical current stand alone railroad that the shipper hypothesizes. If that threshold is crossed, then ultimately under the Maximum

Markup Methodology, the MMM, the regulator, the Board as the regulator compares relative revenue to variable cost ratios to set a maximum reasonable rate.

All those relative revenue to variable cost ratios at that point, I'm talking about any case from today on, incorporate the purchase accounting adjustment in the asset base and it won't matter. Now you can try to hypothesize extreme circumstances exactly the precise effect in case.

But basically the base changes for all of them and as some of the discussion before was, it doesn't make any real difference from then on. It's not a question of something happening later to a base. The base started out with the comparable purchase accounting in the URCS for all of them driving that methodology.

I don't want to go into the weeds of this. But it also would be the case for the costs used in the ATC allocations. If they're using URCS costs in those for the crossover revenues, they're still using the same kind of thing on both sides of divides where they do something.

So we really believe that analysis shows that for stand alone major rate cases under this Board's constrained market pricing its new way, from here on it doesn't alter the ultimate outcome. We'll come back to the jurisdictional threshold. Obviously that applies to all cases. I'm talking about this methodology.

Similarly, if we go to simplified SAC cases there shouldn't be any affect, or any meaningful effect. They are driven off of SAC, they are driven off of stand alone costs. Some of our own stand alone rate cases end up being in the SAC cases and they're still all based on a common denominator of comparability.

Actually, while operating expenses

are used in the simplified case that use URCS costs, these effects should at most be mixed. The roadway portion is not really used and for BNSF equipment was written down in the adjustment we're talking about, which could benefit the shipper.

But in any event, these are cases with a fixed set of perimeters and we've never had a simplified SAC case filed against BNSF. Then if we go to the three benchmarked small, and we should emphasize the word small rate case here, these standards the Board adopted are also largely driven by comparable R/VCs, by relative R/VCs of the chosen comparison group.

The issue that is intensely litigated is the comparison group. But the comparison group and the complaining traffic are compared based on R/VCs that would be based on the same costing base.

The RSAM does come into play, the Revenue Shortfall Allocation Method does have an impact. It's not entirely clear and you have all these moving pieces, how much of an impact or where it would be. It could go up. It could go down. But this is on the margin. This is an adjustment to something that has been determined by the comparability group R/VC comparison that the Board uses to drive the rate.

But finally, these are small cases. And the recovery is limited as been referred to earlier the $1 million threshold for reparations and relief. So if something is going on here it's going to affect, as much as anything, the timing of that 1 million, whether it's stretched out or more compressed. But some of the hyperbole we heard earlier today we think is fundamentally wrong as, in terms of what drives this methodology.

Then we can go to the jurisdictional threshold. The shippers have made much of the fact that as a result of purchase accounting some rates that are above the jurisdictional threshold may fall below it, theoretically depriving shippers of their right to rate reasonableness review. We think this is a red herring.

As Tom Hund has stated and our evidence of our Marketing Officer, John Lannigan stated, BNSF sets its rates based on market factors not where the jurisdictional threshold falls. Leaving aside some of the assertions Mr. McBride earlier made that Mr. Hund referred to when Mr. McBride makes these breezy, incredible, unfounded assertions of manipulation, which are just ridiculous on their face.

Leaving that aside, if we take his comments about rate making, as we've testified and happens in the real world, BNSF Railway rates are based on market forces, not regulatory costs. But that's not just for exempt rates. That's also for regulated rates. And it's a very important factor.

On the threshold, I've practiced in

this area for a very long time, pre- and post-Staggers, it's hard to picture or imagine what cases are brought at the margin of the jurisdictional threshold. That is a statutory concept. It's a safety net.

But as our evidence has shown, as Mr. Baranowski put in his written testimony and I don't think this is much different than Mr. Crowley's testimony, the average impact on URCS costs from this adjustment is about 5 percent. And that probably projects to somewhere in the 7 or 8 percent on an R/VC ratio, I mean you're doing a mark up there.

And the number of regulated shipments who would transition from above or to below the jurisdictional threshold as a result of this is accordingly minimal. And they'd be regulated shipments. And it'd be less then 2 percent of our shipments in 2010. Again it's very hard to picture why this would be a decisional factor or what shippers around the edge are bringing a case based on this minimal impact.

All rate cases, of course, are affected by this jurisdictional threshold. But this is a safety net, driven by statute. And if a case is brought that challenges a truly unreasonable rate, presumably it's high enough that it shouldn't matter and the jurisdictional threshold isn't involved and the threshold never comes into play.

Even Mr. Crowley cited how few rates are close to that threshold and if something is that close the impact should be negligible, excuse me, on the impact and availability of shipper revenues, remedies or why someone should bring a case. But from a policy standpoint, if in a given case the rail world is driven down to the statutory jurisdictional threshold, it should be based on the most accurate costs.

Overall, the impact on existing regulatory remedies is minimal. But even if you have a small impact on the margin from using more accurate costs, there is nothing wrong or unfair with that. And the contrary would be wrong.

There's no valid reason with respect to future cases to not adopt purchase accounting in determining URCS for rate cases and even for the three benchmark method after another year or two. And all relevant data reflects this adjustment.

We should talk and we will about the existing prescriptions. They keep coming up, the cases that straddle this transaction. If the Board has a concern with the unanticipated consequences today of the Board's transition some years ago to R/VC, Revenue Variable Cost based maximum rate prescriptions, as opposed to the nominal dollar prescriptions that were indexed in a formula that didn't use the R/VC formula, were just dollars and cents with respect to the two stand alone cost coal rate cases that pre date or straddle this transaction, such as Western Fuels or AEPCO, they can be addressed.

Now AEPCO involves the jurisdictional threshold. Not even a known maximum markup. I have trouble with that MMM. But I thought I should say it all the way through because it's your methodology. But the MMM methodology, we don't know what the prescription is there. The Board directed it would be below. Okay fine.

But so, the principle is the same with respect to that MMM prescription I think the issue of jurisdictional threshold is somewhat different. But if the Board is concerned with that straddle treatment of Western Fuels the Board could easily adopt a bridging mechanism to retain the original intent of its finding in those cases.

This could readily be done by a one time linking factor to adjust the R/VCs in those cases that could carry forward for those existing prescriptions. One of them is already open before you. The other is on appeal. But they're readily addressable by this Board within its authority without affecting fundamental principles of GAAP accounting and the right thing to do.

In reality the difference between the URCS with or without purchase accounting is on average about 5 percent. The actual application in a straddle case, if it's of concern could be addressed in that case without rejecting established precedent and this doesn't matter at all for any prior prescriptions that are in dollars and cents. Nothing changed under the Board's prior orders.

I don't, finally, revenue adequacy. The other topic that keeps coming up is what is the impact on revenue adequacy and revenue adequacy future standards and determinations. In 2010, BNSF remained revenue inadequate independent of the incorporation of the purchase accounting adjustments.

In fact, BNSF was found to earn the

cost of capital in only one year in the past decade, 2006. Indeed only once since BNSF was formed in 1995. We have never been found to earn the cost of capital over any sustained period of time and thus revenue adequate.

The future cost of capital and future cost of capital determinations for companies, revenue adequacy determinations for a company will be affected by the future cost of capital, the economy and company performance. Those things will determine whether we're revenue adequate or inadequate in the future.

This will have some impact on the numbers. But we then ask ourselves what are the future standards in a revenue adequate world, that one should be concerned with if one should be concerned? Even if BNSF were to be determined revenue inadequate in a given year where the accounting treatment would have changed the result, there's no reason to assume a shipper would be denied access to some kind of remedy.

On the contrary, as we've just discussed, the impact of the accounting adjustment on the availability of existing rate remedies for a revenue inadequate carrier is zero to minimal. The Board has not yet determined under what conditions or for how many years a carrier being revenue adequate should trigger or mean different regulatory standards should apply.

Nor has the Board yet established how and to what extent different regulatory remedies should be made available for a shipper to challenge a rate of a revenue adequate carrier. This is talked about a lot before this Board and otherwise. It'll happen in due course, if that's the situation the industry and the Board'll see.

But in the absence of those determinations, there is no reason to assume any adverse impact upon shippers. If and when future standards are adopted for revenue adequate carriers, we should more reasonably assume that the Board would then reflect the current accounting standards across the board that is has in place and determine how its remedies should apply in that situation.

Current precedent, very well established and proper GAAP accounting standards should not be distorted now or disregarded in this instance for yet undetermined regulatory standards. Thank you.

MR. JENKINS: Good morning or good afternoon. I'm Rob Jenkins a partner at Mayer Brown, LLP. My practice focuses on STB rail regulation and deregulation and I have considerable experience with the issues before you today. I can't claim to be a contemporary of Grover Cleveland's, but I have been doing this at least as long as Mr. McBride.

The shippers bear a very heavy burden here. They have to show why the STB should reverse 25 years of settled policy and law using GAAP purchase accounting for revenue adequacy and URCS costing purposes and apply different regulatory standards to BNSF than to anyone else.

They have not done that and they cannot do it. Acquisition cost is required by the Board's rules and the ICC and the STB have consistently applied acquisition cost in every merger or acquisition transaction since the RAPB recommended its adoption. Nothing about the BNSF Berkshire transaction distinguishes it in any relevant way from every other transaction where GAAP purchase accounting has been applied.

Let's look at the prior transactions. The first thing you'll see here is that in percentage terms the purchase accounting adjustments for the BNSF Berkshire transaction were less than for almost all of the prior transactions. That means that the impact on BNSF's regulatory costs is relatively smaller than in those earlier transactions.

Mr. McBride repeated several times a nightmare scenario where the amount of the acquisition premium was burgeoning, transaction by transaction, when in fact what drives increases in URCS variable costs is the percentage increase in the rate base. It's not the dollar amount.

So all of this talk about billions of dollars of increases in acquisition premiums is irrelevant. It's the percentage increase that matters and here the increase was, as Mr. Weicher has said, about 5 percent.

It bears emphasizing as well as the last column shows that in the Berkshire transaction more than 14 billion was allocated to good will. That's two-thirds of the write up and it has no impact on the regulatory costs. No other railroad merger or acquisition had any appreciable amount allocated to good will.

Thus, from a regulatory standpoint the effect of the BNSF Berkshire merger on the railroad's costs is less than in most prior transactions. All of these transactions were approved. All of the prior transactions were approved by the ICC or the STB and acquisition cost was used to value the railroad's costs for revenue adequacy and URCS costing purposes.

Now Mr. Crowley and some of the other witnesses here today claim that the other merger and acquisition transactions are distinguishable because they involved merger synergies. You can see from the chart, and Chairman Elliott had a colloquy with Mr. Crowley about this earlier, that one of the prior transactions was the acquisition of CNW by Blackstone, which is an asset management and financial services company.

No one claimed there that acquisition costs should not be used because there were no merger synergies. And the cost benefits that they cited to were basically the result of operating plants. There was no tie into acquisition costs.

If they had, the other thing is that in none of the other transactions, save one, the Conrail case which we'll discuss in a minute, was there any discussion about acquisition cost. Mr. Crowley suggested that somehow shippers had, through a tradeoff between merger synergies and acquisition costs.

That's simply not the case. There was no discussion at all about the acquisition premium. It was applied as a matter of course, because that was what the Board's rules required and that was what their precedent required.

If they had claimed that acquisition premiums should not be permitted, they would have lost. Because the RAPB and the ICC and the STB did not require the use of acquisition costs because of merger synergies. They required it for economic accuracy and to comply with the statute.

Two federal circuit courts of appeals have affirmed the ICC's and the STB's decisions for the same reasons. Now the one case that has talked about merger synergies in connection with the acquisition premium is the Conrail NS CSX case. And let me stop right there and note that there were clearly merger synergies in that case, but that didn't stop the shippers from attacking the use of acquisition costs there.

They attacked it with merger synergies and the STB did note that there were merger synergies, but the foundation of the STB's decisions in the Conrail case, decision in the Conrail case, were economic accuracy, its own rules, the statute and established precedent. Here's specifically what the STB said.

The Board here emphasized, this is in the Conrail case, that its rules and prior precedent require the uniform application of acquisition costs for revenue adequacy and jurisdictional threshold calculations. I'd particularly like to draw your attention to the last sentence of this holding.

Mr. LeSeur and Mr. McBride have suggested that the acquisition premium is supported by BNSF and was adopted by the RAPB because it was an accounting rule. Well that's not why it was adopted. It was adopted because it was the most economically accurate measure of costs that the Board has available.

The RAPB endorsed acquisition cost primarily, and this is a quote, "because it better represents the economic conditions facing the enterprise than does predecessor cost." And the ICC in turn determined that it did not matter whether the acquisition cost was above or below book value. The use of acquisition cost was necessary to accurately measure the real value of a railroad's assets at the time of the acquisition.

And the ICC's position, which the shippers supported, was affirmed by the DC

Circuit. Now, let me go back to the shipper support point. Mr. McBride says memory can play tricks on you. And apparently it played a big trick on him here because he said that electric utilities always took the position that the Board should use predecessor cost.

That's not true. I took part in both the RAPB proceedings and in the Conrail proceedings and in the appeal to the DC Circuit, but I'm not relying on my memory here. If you look at the ICC's decision that was appealed to the DC Circuit and this is at 6 ICC 2nd 933 and the cite to the particular page is to 939.

It says EEI, that's the Edison Electric Institute, that's the association of the electric utilities. EEI also supports the use of acquisition cost. EEI argues that we should not switch methodologies simply because they happen to affect revenue adequacy determinations. One method should be adopted and used regardless of the results.

That was the EEI speaking. It also notes that the National Industrial Transportation League took the same position. While I'm on, looking at this case I should also answer another point that Mr. McBride made, which was he said that the only issue in the ICC case was sales of railroads below book value.

In fact, the ICC in this proceeding, this the revenue adequacy 1988 proceeding, specifically addressed adopting a uniform position that it would apply regardless of whether the railroad was purchased for a price below or above book value. And they said it about that in particular with respect to sales above book value.

If we understate the value of railroad assets in applying the costs of capital standard, the revenue requirements of the railroads will be understated relative to the investors expected rate of return. They also said that on using book value, when the railroad was acquired for more, using acquisition cost, no using book value, when the railroad was required for more than book value, would potentially shortchange those recent investors who have been paid a premium above the old book value with a return below the cost of capital for their investment.

So, that brings me back then to the decision in Conrail because Mr. McBride also talked about the statute. And here is what the Board had to say about the statute, the statutory foundation of its rules from a costing standpoint and here is what the Board had to say with respect to the, let's see, is this the costing? No, this is, yes is with respect to revenue adequacy.

So they had a statutory foundation for both their costing and their revenue adequacy determinations. I should also point out that in the Conrail decision, the STB rejected the analog to other regulatory, other regulated industries.

In every single proceeding where this has come up the shippers have raised, someone has raised the question of an analogy of different treatment in other regulated industries. And the ICC, the STB and both Courts of Appeals have expressed they rejected those analogies.

You know, these findings and conclusions of the STB are just as applicable to the BNSF Berkshire transaction as they were to the Conrail CSX/NS transaction and the other transactions that proceeded it. None of these conclusions was based on merger synergies.

You know, the 2nd Circuit also affirmed the STB's decision without any reliance on merger synergies. There was discussion earlier about the fact that the 2nd Circuit was moved by the fact that there were merger synergies.

Well that's not exactly what the 2nd Circuit said. What the 2nd Circuit said was that even if no efficiencies were captured by these transactions, thresholds for rate regulation would only rise 7.26 percent for NS and 4.9 percent for CSX.

As we've discussed, it rises about 5 percent for BNSF. So if you're concerned about the amount of the increase it's well within what the 2nd Circuit thought was reasonable for the STB to affirm.

I should also point out that two years later in the major railroad consolidation procedures rule making, the STB held again and I quote, "there is no sound economic justification for using predecessor cost rather than acquisition cost to value an acquired railroad's assets." And again, there was no reference to merger synergies.

So the economic and legal foundation of the Board's rules are clear. And the Board's application of those rules has been consistent. Mr. LeSeur and Mr. Crowley and other people have talked about unfairness and they claim that it is unfair or inequitable for the Board to apply rules that could have some adverse impact on them. Now Mr. Weicher has discussed the fact that there are unlikely to be any significant adverse impacts on the shippers.

But even if there were impacts, there is nothing unfair about evenhandedly applying economically accurate costs regardless of who benefits. What would be truly unfair and arbitrary would be to knowingly apply economically inaccurate costs to favor one party over another.

Mr. Crowley has suggested that you should look at this on a case by case basis. And it has always been the case that the ICC and the STB have said that they don't automatically apply the acquisition premium.

If someone can show that the result of applying the acquisition premium in a particular case would be skewed because the investment base was inaccurate, not in conformance with GAAP or was inflated, then on that basis you could apply something other than the acquisition premium. But in this case, there's no challenge to the premium that is being incorporated in the investment base here.

WCTL has expressly said that they're not claiming that the acquisition premium was inflated or not bonafide. So that issue simply doesn't apply. Finally, let me get to this question of fair and accurate. Nobody contends that predecessor cost is more economically accurate than acquisition cost. I agree with Mr. McBride that you ought to be using fair and accurate costs and the most fair and accurate costs are acquisition costs.

So from the standpoint of good policy and good law that should be the end of the matter. Shippers have not demonstrated why Berkshire's acquisition BNSF should be treated differently than the rail mergers and acquisitions that came before.

The Board has a responsibility to apply its rules consistently and evenhandedly. It should treat the BNSF Berkshire transaction the same as the others and dismiss WCTL's petition.

DR. WEIL: Ready for me? I'm Roman Weil. I am from the University of Chicago not from the BNSF Railway Company, so I tried to scratch this out here. I've been a scholar and a professor over 45 years. I started life with a PhD in economics, taught economics. I still think I'm an economist, think like an economist.

But about 35 years ago I started doing microeconomics accounting. I became a CPA and I've written a dozen textbooks and professional reference books mostly about accounting. The, I think though I'm an economist who knows something about accounting.

The most important part of my training in converting from being a professor of economics to one of accounting, was writing an accounting dictionary. It sensitized me to the fact that accounting language, the language of business uses ordinary every day English words, but uses them in technical ways and ambiguous ways.

Example I use most with my students is the phrase making money. You all think you know what making means. It means six different things in addition to counterfeiting.

The most ambiguous word in the accounting finance vernacular is the word capital. It can refer to assets. It can refer to equities. It could refer to the entire sum on the left-hand or right-hand side of the balance sheet or a portion of it. So the word capital is ambiguous.

The worst reserve in all of accounting is reserve. In this case there are two words or terms that are ambiguous and as I sit and listen cause trouble here. Mr. Hund and Mr. Jenkins have talked about those two.

The one is the word premium. I heard some of the other folks saying that this was not arms length and the premium paid could have been more or less. All of the premium that he was talking about, ends up in good will. It does not affect the regulated rate base here that we're talking about. That's the $8 billion number.

The purchase accounting assessments that were done by accountants and with aid from outside CPA's. The amount that was maybe or maybe not at arms length, that ends up in good will whatever it is, not part of the regulatory pieces. Mr. Hund said that.

The other word or phrase that is being slung around here, and Mr. Jenkins is just focused on it is, accurate or economically accurate. Since I wrote a dictionary, I know to go back to sources. I went to the RAPB writings. And I could find economic accuracy only in one caption, not in a paragraph, but in a heading. And in the paragraph under that heading it refers to current economic conditions.

So when you talk about accuracy in this framework, I think you should always use the two word term, economic accuracy and focus on current economic conditions. The accounting expert on the other side and I both agree that old historic predecessor numbers are accurate, single word, that is to say if you look at a bunch of invoices and add up the numbers you get a number that's accurate.

If you look at acquisition costs, those are accurate. But the issue here is not accurate in that sense, in the footing and ticking and auditing sense. It's economically accurate, current economic conditions.

Now I have known since I first started studying economics that you want to focus on what economists call opportunity costs. That's the way people make optimal decisions. We're here trying to figure out how to allocate society's scarce resources in order to maximize the wealth of the nation. And you do that when you focus on opportunity costs not on old, out of date historic costs.

I've been challenging my students for 30 years to come up with an example of any decision that any business person has to make that is better made using old historic costs rather then current values, other then where it's decreed by law, like a capital gains transaction or a property tax valuation or in a stewardship calculation.

But if ever a business person is facing a decision, that business person wants to know the current value of something, not its old outdated historic, your building burns down and you're offered an insurance settlement by an insurance company. You don't want to know what you paid for that building 20 years ago. You want to know what's it going to cost to replace today, is one example.

I challenge anyone, because I've been trying this for 30 years, to give me any example of a business decision that is better made on historic costs then current costs. So I'm really here as an economist asking you to focus on economic accuracy and understand that means opportunity costs. And you need to focus on opportunity cost to use assets productively for the increase of the wealth of society.

In addition to that I can say that GAAP says use the current purchase cost. That's been said. It's said again. There's no dispute about that. The thing I think you need to do is to focus on the term economic accuracy and understand that means current economic conditions. And allocate our resources using those data, not the old historic data. I think I'll stop there.

DR. NEELS: Thank you. My name is Kevin Neels. I'm not with the Burlington Northern Railway either. I'm a principal at the Brattle Group where I lead that firm's transportation practice. I'm also the Chairman of the Committee on Freight Transportation Economics and Regulation of the Transportation Research Board. I have a PhD from Cornell and I am an expert in regulatory economics and in particular STB regulation of rail markets.

I previously submitted written testimony in this proceeding with my colleague, Lawrence Colby. BNSF has asked me to comment here on the reasons why some of the analogies that witnesses for shippers have drawn to other regulatory, regulated industries and regulatory schemes do not apply to the railroad industry or to the STB's regulatory policies and procedures.

A lot of this, the discussion about the appropriate treatment of acquisition premiums has to do with the way in which these premiums are treated under cost of service regulation. It is true that some industries are subject to pervasive cost and service regulation.

The firms in these industries charge regulated prices based on their costs. Their costs or these costs reflect an original cost rate base and a regulated rate of return. And it is true that in these industries acquisition premiums are typically excluded from the regulated rate base.

But it's also important to recognize that original cost regulation is applicable only in situations in which the regulated entity is not subject to material competition. It is used in situations in which there is generally no concern about the ability of the regulated entity to earn an appropriate return.

And in fact in which there may be concern that absent regulation the regulated entity would earn more than an appropriate return. Thus this type of regulation protects both rate payers and investors. It guarantees that rate payers pay no more than they should. It also guarantees that investors earn no less than they should.

In the rail industry investors enjoy no such protection. In the rail industry there is no rate base for rate regulation purposes. As we've heard, rates are set in the first instance based on market conditions and based on the demand that railroads perceive for their services.

Only in a handful of cases are rates set by the STB. And no rate is set based on original cost accounting. Thus the concerns that have been raised about possible perverse effects under original cost accounting don't arise. The perverse effects that have been cited have to, excuse me, have to do with circularity and the potential for a double counting, or double payment for the assets put in service.

Now the circularity concerns have been discussed before. I'm not sure if there's much more to say other than that given all that we have heard about the fact that most rates are set by competition, that there is, excuse me, nothing analogous to a rate base that much of the acquisition premium went into good will, which has no effect on regulatory, any regulatory determination. There seems to be no concern here really about circularity.

And on the double counting issue, I think that this concern arises under original cost regulation when you have a situation where rate payers are paying rates that reflect a nominal cost of capital applied to an original cost rate base. In that situation, if it's applied consistently the compensation for inflation comes to the investor through the rate of return.

And there is a sense that if one were to allow acquisition premiums to go into place that there would be double payment. That situation doesn't arise in the railroad industry. In fact, in the railroad industry no railroad has consistently earned its cost of capital.

And so in a real sense, the customers of the railroads haven't yet paid once for the assets that they use. Because of the nature of competition in the rail industry, the original cost regulation is fundamentally incompatible with rail markets.

Railroads are subject to material competition. Competitive rates vary more than regulated rates. They have a different pattern over time. If one were to try and subject the railroads to original cost regulation, at various points either the regulatory ceiling would bind or the market forces would constrain rates.

The result would be that the railroads would be left with the worst of both worlds. And they would be unable to earn a rate of return. Thank you.

MR. WEICHER: Chairman, would you

allow Mr. Hund an extra minute to recap for questions, is that correct?

CHAIRMAN ELLIOTT: Of course.

MR. HUND: Okay. So I'll make this very brief. First of all, as you can see on the slide, all post Staggers rail mergers used GAAP. And the Board should not depart from decades of established policy. There's no defensible rationale for changing the general application of this precedent.

But I think most importantly, it would be bad public policy to go to a world of ad hoc exception-based departures from GAAP for railroad accounting and costing. BNSF's policies and practice are to set rates based upon market conditions not regulatory cost. And as I think we all agree, there's only a minimal amount of regulated traffic that's potentially affected and only modestly. And that's in the 4 to 6 percent average change in URCS.

And the Board has effective remedies

available to address any transitional anomalies in existing cases or prescriptions. And as Mr. Weicher described, and you should use those in the cases where justified. And I'd like to address one final point and that's on, there's been discussion of synergies and benefits about the Berkshire acquisition. And I'd like to say that first of all it's incorrect to say there's no synergies.

I would describe them as very modest and modest being in the 10's of millions of dollars. For instance, we no longer have an arrested relations function. We no longer have an outside Board, audit committee, compensation committee, registration of stock, all of the fees that we pay associated with that.

So there's modest synergies, but I would never say they were enough to justify the acquisition. But I think the real benefits of Berkshire ownership of a railroad, a company like BNSF, are that Berkshire has a long-term perspective. On the day of the acquisition Warren Buffet described it as this is day one of the first hundred years of ownership of BNSF.

And if I can simply describe the way cash works in the company. Berkshire doesn't demand an amount from us to pay back the premium they paid or anything like that. What they tell us is invest all the capital you need to maintain a strong railroad and invest all the capital you need that justifies expansion or efficiency, based upon good economic decisions. Send us the rest.

So I mean that's just wonderful from a CFO's perspective to have that type of owner. A great example was last year when we had significant flooding and we had hundreds of millions of dollars of damage in the second and third quarter.

We called Berkshire and said the dividend we had anticipated paying you is going to be less because we need to put our railroad back in service. That conversation lasted five minutes. And they said we understand. Do what you need to do to maintain a strong railroad. Send us the rest.

And so then let's go back to a little bit of so why did Berkshire buy BNSF in the first place? Why is this a benefit? I mean, first of all Berkshire does have this long-term hundred plus year time horizon. And secondly they invest in what they perceive to be as solid businesses that generate reasonable returns.

And so as far as the railroad industry and BNSF in general, BNSF specifically rather, they're bullish on the long-term future of America. And they know that the railroads and BNSF specifically provide a great service to the economy of this country that they're bullish on.

So that's really the reason why we're now a subsidiary and have been for the last two years of Berkshire Hathaway. Thank you for the extra time.

CHAIRMAN ELLIOTT: Thank you very much. Commissioner.

COMMISSIONER BEGEMAN: Repeatedly in the testimony that several of you have given, you've talked about the accounting adjustment not having a meaningful impact or a minimal impact at best. And I'm curious to know at what point would you agree that there is a meaningful impact that might warrant the Board taking a different approach to it following GAAP?

MR. WEICHER: If you're referring to in terms of rate cases, I think it would, well it would also really have to be a case by case situation if there was something aberrant in a particular transaction. Anything like this that is currently in the single digits, the precedent you've seen and that Rob Jenkins took through is part of the endless evolution of railroads.

Who knows what will impact future

costs of railroads and what makes a major impact to compare these things to. We make massive investments. We have investments we'll be making for things like PTC, we're always buying locomotives. So to put in perspective of the prior transactions this is quite modest.

I don't think, to be more direct, there's any absolute standard that you can envision. It would have to be in context to the dollars and the amount and what it did to cases.

Having said that, we really think, I really believe that if you look at your rate remedies, once your past the transition, once your past Stagger, there is no real impact, except at the margin or lost in the noise. Because all these standards, once it's in the comparable bases, take away the impact.

COMMISSIONER BEGEMAN: But for argument's sake, let's say 10 percent of grain shippers, of your grain shippers, no longer meet the 180 percent market dominance threshold. Is that something we should consider?

MR. WEICHER: Frankly, I don't think that would be a substantial impact. But having said that, we have many rates, regulated rates, below 180 percent. There is this impression given by some of the speakers this morning that exempt rates, all our rates are driven with the market.

They admit exempt rates are and that some how those are down here and the others are up there. In reality, we have plenty of regulated rates below 180 percent. So I don't know how you would get to that point where you'd know that a given set of shippers or rates are above.

But having said that, I don't think 10 percent would be enough to change something this established. This is also something that evolves over time.

COMMISSIONER BEGEMAN: Mr. Hund, I

think one of the comments that you made was that if we did go a different route you would be required to keep two sets of books. What would some other impacts be?

MR. HUND: I would say that, the biggest that I would say is by not following the precedent of GAAP, the two sets of books is I'll call it a modest administrative, I'll even call it a nuisance, okay. I mean, that's not a reason to do something or not do something.

It's really more the, what I all the introduction of uncertainty and uncertainty equates to risk. Because what we end up saying is then no one knows what the standard is. Because we're going to an ad hoc basis. We're going to a case by case situation.

So each transaction that takes place, whether it be a major merger or an acquisition of say a Class 2 or 3 something like that, we don't know what the regulatory framework will be and we've sort of broken from a long pattern of history. And any time there's introduction of risk that is something that impacts a decision making process.

So I think there's, you know, it's much better to stay with a, first of all, a set standard that is enforceable and enforced by the SEC and is the requirement is at least 25 years of precedent here at the STB and its predecessor agency and then deal with those exceptions that truly need to be dealt with.

COMMISSIONER BEGEMAN: With respect to the premium itself, is it safe to assume that you used a replacement cost approach in developing the $8.1 billion figure?

MR. HUND: I would say it's different from replacement cost modestly. It's very, very close. But first of all, we did it as of a specific date, which was the 10th or 12th rather of February 2010. So it wouldn't necessarily be a replacement cost today or any time a balance sheet's issued, it's just as of one date.

When we typically talk about replacement cost we say as of each balance sheet date you're measuring replacement cost. So I guess you could argue it was, you know, close as of that date.

And then it comes down to replacement cost. Let me make sure that, I know I talked about this, but we talked about the fact that we looked at the productive capacity and not replacement of assets in place.

And a great example of that is, we have three lines going from, through the State of Washington out to the Pacific Northwest, and they work three different ways through the state. Now we assume that we had one more substantial line going through the State of Washington and eliminated all the duplicative routes.

We looked at our facilities in Chicago where we have four major facilities spread out throughout the city and assume that

all that was one. So we didn't just replace
what existed, we replaced productive capacity.
So with, I guess those caveats, I'd say it's
fairly close to what you would define as
replacement cost.

COMMISSIONER BEGEMAN: Before my time
here the Board had a proceeding. I think it
was initiated at the request of industry --
to consider a replacement cost approach, which
was rejected. How does what you have
done then compare with the book
value for the rest of the industry? Should
they be given the opportunity to --

MR. WEICHER: Commissioner, if I
may, I participated in that proceeding and
there are some important distinctions. I
believe you're referring to the proceeding
that came before the Board to adopt
replacement cost for costing purposes for
revenue adequacy purposes as a basic base.

That was more of a replication of
entire systems as opposed to the functional

utility approach Tom Hund described. The Board rejected that and they rejected it in part because the Board didn't, as I recall or read it, did not feel it adequately dealt with surplus assets or how to look at the current condition of the assets.

The accounting driven study that Tom Hund referred to is not the replication of today's system in full on a replacement cost basis. It is this functional utility concept to serve our customers and is a different number. But it was also driven by this accounting process, not by the regulatory elements that were before the Board in the replacement cost case.

MR. JENKINS: Let me try it. The other thing that is different is, what was at issue there was calculating replacement cost every year and coming up with a system where you revalued every year and applying a real cost of capital to that. And the Board determined that it was just impractical to do that every year. So did the RAPB.

But that didn't prevent the RAPB from deciding that you ought to apply a nominal cost of capital to GAAP purchase accounting when you had a purchase. So it's apples and oranges. Because what we have here is we have GAAP purchase accounting and as Mr. Hund just testified, it's frozen in place.

COMMISSIONER BEGEMAN: So help me understand how your write up of $8 billion compares with previous acquisition write-ups. I think, there was a $3 billion markup for one entity, et cetera. I mean the $8 billion is quite large in comparison to other actual merged carriers.

Did they not use a replacement cost approach? I understand you can't quite comment on their approach because you were not participating, but it --

MR. JENKINS: Well, first of all the industry was much smaller then. So these were smaller railroads and the transactions --

COMMISSIONER BEGEMAN: But the UP/SP merger, I would not consider small.

MR. JENKINS: I said smaller. I didn't say small. No there was still significant money involved. But the, as we discussed, as Mr. McBride was talking about --

COMMISSIONER BEGEMAN: The value just wasn't there.

MR. JENKINS: The values just weren't there. But the percentage increase was sometimes, well in almost every case was greater than the percentage increase here.

(Off microphone comment)

So yes, UP, Professor Weil is pointing out to me that UP SP the increase was 74 percent. And nobody raised a question about using acquisition costs there.

Now you did have another question which is should now we raise every other railroad's investment base. And --

COMMISSIONER BEGEMAN: Which I know the other witnesses before you would certainly strongly support.

MR. JENKINS: Well, Professor Weil would you like to --

DR. WEIL: One of the operable principles in economics is you don't let the best be the enemy of the good. I've said that in my report. We say it all the time in policy. It would be best if we could costlessly learn the opportunity cost of every asset at every balance sheet date every single quarter.

But the world doesn't work that way. To get these data is expensive. I don't how much BNSF spent to get that allocation of the $8 billion to the assets. But if it were possible to do it every year, I think the policy should be to do it every year.

But since we don't want to spend those resources getting those data, we take it when we get it. When you have a purchase acquisition, generally accepted accounting principles require that you spend what it takes to get the right data. It would be nice to do that every year for every company. But and you could I suppose require it, but it would be an expensive undertaking.

MR. WEICHER: And, Commissioner, if I may. We are asking you to adhere to precedent for applying GAAP for the purchase accounting adjustment in an acquisition. That is different than what you do in an industry wide basis. We'd be following the same precedent here you've done in prior merger cases.

That does not require or drive changing other precedent. You looked at this other issue a couple of years ago. These issues keep coming back and when and if you see fit that can be addressed. But this does not compel any change in other standards, following precedent in this transaction.

CHAIRMAN ELLIOTT: Just a few questions. I guess I'll ask the question I asked the shippers only to be fair. Back in the late 80's when we were addressing some of these issues about what type of accounting to use I believe that you took the opposite position, the railroads did. And I guess the question is the same. What has changed since then? Or what reason is there for taking the flip side of this?

MR. WEICHER: Two elements and I think two of us at the table were practicing for the STB at that, ICC at that time. First there were basic differences like has occurred in other industries of the value of the assets compared to the market being under as opposed to over.

Having said that, BNSF has never taken a different position. And may it was probably part of industry groups our predecessors were they were different. And those were different situations.

Having said that, the Surface Transportation Board and its predecessor the ICC, have stayed consistent through all of this.

MR. JENKINS: I would also point out that the AAR's position back then was that the value of the railroad's assets had been driven down by poor regulatory policy, which I continue to believe to this day.

The ICC in response to that said our decision will be driven by what is the most accurate and reasonable valuation in each particular case. If we find that the acquisition price was held down or depressed primarily as a result of government action or policy, then use of acquisition cost would not be appropriate.

Where the AAR lost in that proceeding, was in convincing the ICC that in fact their rates had, that their investment bases had been driven down by poor regulatory policy. The ICC took the position that because most of the rates in the country were set by market demand that they didn't feel that there had been a material effect as a result of the regulatory policy.

And so, and that they were going to adopt a uniform position since it would apply both ways, whether the sale was for above or below book value. So the AAR's position was a, was based upon an honest belief, but the AAR lost.

CHAIRMAN ELLIOTT: And that would be my answer. I lost and now I'm found, in the law. So having lost many cases in my career, surprising. The other question, and it actually came from the same section in the shipper's brief regarding double counting of inflation, and I'll, it's from Page 40 of WCTL's joint opening statement and it's a direct quote from the rail member of the RAPB.

And the quote is, "If the purchased railroad is financially strong, continued inflation will have driven up the current values of its assets well above depreciated original cost of its long-lived investments. The acquisition price will, therefore, be higher and the new owner would have the ability to raise rail rates to higher levels than would be allowed under current ICC practice.

Shippers which have paid once for the impact of inflation could be called upon to pay twice for the same escalation of values. This is the same type of double count for inflation the Board assiduously avoided in its pronouncements on abandonment and cost to capital questions."

Obviously back then you were, you know, supporting the shipper's positions, and, but I wonder, it seems that statement is different than the statement you've been making here today about the effect of the double count of inflation by using nominal cost to capital.

MR. JENKINS: This is Mr. Briggs' statement?

CHAIRMAN ELLIOTT: That's correct.

MR. JENKINS: Yes. It's wrong. I

mean the fact of the matter is that the state of play back then in the mid 80's was such that we were unsure how regulation was going to play out. And as it's played out it has no effect or minimal effect.

CHAIRMAN ELLIOTT: Okay. Well I appreciate your candor admitting that your predecessors were wrong. Is he still alive, Mr. Briggs? Next question, just in listening to your testimony I'm hearing that there isn't, your position is there's not going to be a great effect as a result of this asset write up.

And I guess the question is, you know I asked the question about SAC and I tend to agree with what Mr. Weicher was saying, that going forward in SAC it may not be really an effect that you would have. Then the other side raised the issues with respect to the Western Fuel case.

And I thought I heard some pretty positive responses from you that could be dealt with. And would you be comfortable in dealing with those two cases in the way that you mentioned with respect to the link?

MR. WEICHER: Chairman, comfortable is a term that I'm not sure exactly how to say. But that would be the appropriate and right way to deal with the issue if you see an issue there.

CHAIRMAN ELLIOTT: Sure.

MR. WEICHER: We don't throw out a system and take, disregard 25 years of precedent. If there are a couple of situations that seem anomalous or transitional or are in an unanticipated situation as a result of this transaction, you can and if you feel that way should address them in those cases. Because it's not that complicated to fix it there if it needs to be fixed and leave the basic structure of railroad costing and accounting intact following your precedent.

CHAIRMAN ELLIOTT: And then if we handled it, you know, separately in the specific cases themselves and then my understanding, other than the jurisdictional threshold moving a bit and then if you did have a case that was under 180 there might be some effect. But overall what I'm hearing is there's not a huge amount of effect that you're seeing. So I guess the broad question I have is why exactly are we here fighting over this?

MR. WEICHER: Well the petition was brought by the other party. But we think at the end of the day the right principles for accounting for regulatory costing and accounting for this transaction should be followed for long-term consistency, predictability and to avoid uncertainty. This is all driven by external requirements of SEC and GAAP. And it should be done the right way.

MR. HUND: That's right. I actually in one of my answers, I think to Commissioner Begeman's earlier question is to go to an ad hoc basis of determination of the proper way simply introduces uncertainty and risk and all that associated with every transaction, every purchase of anything that's done. And we think sticking with the long-standing precedent and dealing with the limited number of exceptions to make sure that there is, you know, action can be taken on those is a much more appropriate way to go.

DR. WEIL: Can I speak on that? We give the theorist approach. There's no question that uncertainty increases risk. Now how does that effect a business man? It increases the discount rate that he uses to get the present value of cash flows projected from projects.

When you have more risk, more uncertainty it's a bigger discount rate, gives you smaller present values and it means at the margin there will be fewer projects that you would undertake than when you have the certainty of the regime going forward to make decisions.

So I would think, from an outsider, an academic, the main reason they'd like to get this done is so that they can have the level playing field that they can anticipate for making business decisions going forward and not have to worry about the uncertainty that will induce them at the margin to reject projects that would be otherwise a good deal for everybody.

CHAIRMAN ELLIOTT: Last question. And it goes to one of the questions I asked the shippers, but you look at the results here also with respect to revenue adequacy and obviously by allowing the write up that you all become farther away from revenue adequacy as a result of the write up and I don't think that's disputed.

And something seems inherently, you know, wrong about that because nothings really changed. Now this gets to the proposal I made to the other side which was warmly received and that is a joke for the record, with respect to having a phasing in of the write up and as a result taking some of the perceived inequities out of the mix.

How do you feel about a possible phasing in, especially considering that there isn't this grand effect that we're seeing that you said that won't occur as a result of this write up?

MR. HUND: I'll start and then, Rick can clean up whatever I get wrong here. I mean, I'd say that, it certainly wouldn't be our preferred alternative, which of course you know. But I think, you know, as an alternative it's possible.

I think there would be two issues to deal with. One is what's the appropriate period of time. And so we think perhaps if it was over a relatively short period of time, a number of years, perhaps something like that could work. But the time period would have to be dealt with.

And secondly, the mechanism by which you do it. I mean, it's hard to answer in the affirmative or negative without understanding necessarily maybe some of the details and how you would deal with it, but I, I'll say it is possible. Does that, go ahead and clean it up, Rick.

MR. WEICHER: I will certainly not correct our CFO. I will say --

CHAIRMAN ELLIOTT: Good thinking. Good career move.

MR. WEICHER: I will say as a matter of regulatory principle, it would not be correct. It would induce or inject again this sort of ad hoc treatment. This Board and its predecessor have had many, many major mergers of vast consequences they've dealt with for the last 25 years.

And they've had some consistent rules in consistent areas, including following GAAP. Following GAAP the way it comes through that Tom Hund explained and Professor Weil has described. So you ought to stay with the rules in these areas to have consistency and avoid sort of exception-based deviations. But it's of course possible.

CHAIRMAN ELLIOTT: Thank you. Vice Chairman.

VICE CHAIRMAN MULVEY: A couple of minor questions. I was interested in the process by which the, I guess it was Ernst & Young, divided up the premium to good will and asset valuations. I saw the submissions but was the Ernst & Young study part of the submissions? Is that available?

MR. WEICHER: Extensive work papers were provided. There were work papers given, made available to the parties. They were made available to the staff. I don't know that I can address the studies are out they're not --

VICE CHAIRMAN MULVEY: Mr. McBride suggested it was a black box and that the principal spokesperson for the other side didn't seem to know exactly how the $8 billion was carved out. And you mentioned, I did know this, that there were 6,600 miles of rail rights-of-way that were not valued because they were either duplicative. So, theoretically if you valued the entire railroad, including that 6,600 miles, you could have assigned even more to assets than only the $8 billion. Is that correct?

MR. HUND: Yes.

MR. WEICHER: And it's a bit higher. But again this was not, sorry --

MR. HUND: If you simply replaced what existed, it would have been a substantially higher number. And even if you took the locomotive's freight cars and simply said, you know, they exist therefore I'll assign a value and, you know, whatever that would be, I mean, many of those we assigned zero value because of the time in the economic cycle we were doing this as of too.

VICE CHAIRMAN MULVEY: The proper valuation of the railroad, replacement cost versus book value, is an issue that's been before the Board several times. The Board has in the past rejected replacement course and largely for the reasons that Professor Weil has mentioned and that is it's very difficult to do, especially on an ongoing basis.

Having said that, it is true it has been done before. I believe back in 1920 their Valuation Act required that the nation's railroads be appraised. Mr. McBride, I guess, is the only one who remembers that. But he and I were there for that. And they did value the railroad. But today it is very difficult to determine what will need to be replaced and what is redundant and will probably not be replaced. And finally exactly what is the true value of the remaining assets.

Having said that, I think it is also true that economic analysis suggests that the opportunity cost, the replacement cost is probably the "better" measure. But it may not be an attainable one and as Professor Weil pointed out, you can't let the best be the enemy of the good. I'm also an economist. It is a fundamental theory of economics.

You also said that costs do not affect railroad rates. Is that true of PTC and coal dust and all of those other costs? It struck me from pleadings in those cases that there were decisions that these increased costs certainly were something that needed to be incorporated in rail tariffs, which therefore would be reflected in the railroad rates. Would you want to clarify that assertion a bit?

MR. WEICHER: We certainly spent a great deal of time justifying rates before this agency involving costs. And costs are of course relevant, the cost of service is of course relevant to the rates we charge. The point that our testimony has shown as Tom Hund said again this morning, we've said our rates are not driven by regulatory costs.

There is a distinction. And when we

defend our rates in the regulatory arena of course we have to look at the costs and there are issues of what costs should be attributable to what movements as part of this regulatory function in all these different rate cases. That is distinct from whether we in the marketplace are being set, are setting rates based on regulatory costs. Other than of course when the Board prescribes something.

VICE CHAIRMAN MULVEY: There's been some talk about the jurisdictional threshold and how this might affect the number of railroads, the number of shippers rather who are affected by the jurisdictional threshold, easy for me to say. Do you think the Congress ought to revisit the jurisdictional threshold?

It's never been clear to anybody exactly or precisely where the 180 ratio came from. Is this something that perhaps we ought to move away from, maybe not even have a jurisdictional threshold, but rather look more at a qualitative assessment as to whether or not the railroad is market dominant rather than having the 180 R/VC rule?

MR. WEICHER: Vice Chairman, if I may, from a general regulatory standpoint I will try to make this brief because one of your prior speakers might have, I'm not going to give some long extrapolation as Mr. McBride did. The regulatory standards can always be subject to revision and improvement.

There are issues involving the way the Board applies its market dominance standards, whether they are broad enough and include product and geographic and so forth. But through Congress' direction and then the rulemakings the Board has done, it has a structure in place.

And I will certainly defer to broader authorities and I think we would, it's not part of this proceeding whether at some point as just has been the discussion the last couple of years, there should be changes to some of these regulatory standards. Having said that, the revenue to variable cost threshold, as long as it's there in Congress should be driven by the most correct cost.

And if I could make a comment on one thing you asked before, if I could go back for one minute about the dispute over the 8 billion level. That was really coming into this hearing not something that had been picked at. It was a lot of rhetoric we heard today that suggests there's something there to be concerned about.

In any event, the 180 is probably a little like another one of those things. I have heard the same things and I think I have heard you speak to the derivation of where the 180 comes from and whether it's really shrouded in mystery or what it was. And it sounds like it was a number that was decreed. And until it is otherwise decreed, I guess we'll live with it.

VICE CHAIRMAN MULVEY: My last question is you mentioned that only 2 percent of total shipments would be affected. Two percent of what? When you say total shipments is that total number of shipments, value of shipments, ton miles? You know there are so many ways in which it can be measured, and you get a different number depending upon how you look at it.

MR. HUND: Yes. I think actually in my testimony I described it as less then 2 percent of the 9 billion shipments in 2010, I'm sorry 9 million shipments in 2010. And a shipment would be defined as a rail car, a container or a trailer.

VICE CHAIRMAN MULVEY: So it could be more in terms of tons, more or less in terms of ton miles, more or less in terms of revenues depending upon what other things --

MR. HUND: Sure, I mean, if we measured those, I mean, I'm not sure what the measurement, whether it would be more or less. But it would be, you know, it would be a different number if you looked at revenue versus ton miles versus any other metric, sure.

VICE CHAIRMAN MULVEY: Right. Okay, thank you very much.

CHAIRMAN ELLIOTT: If it was 9 billion we wouldn't be here today probably.

MR. HUND: Yes. Sorry about that.

CHAIRMAN ELLIOTT: Thank you very much.

MR. HUND: I've always had trouble with numbers.

CHAIRMAN ELLIOTT: I can understand.

VICE CHAIRMAN MULVEY: A billion here, a billion there, pretty soon --

MR. WEICHER: Thank you very much.

CHAIRMAN ELLIOTT: I'll now call Panel Number V, which is the railroad interests. This is the Association of American Railroads. Welcome and Mr. Gray, you have ten minutes.

MR. GRAY: Thank you, Mr. Chairman. Good afternoon. My name is John Gray. I'm

Senior Vice President of Policy and Economics for the AAR. And in that role I participate frequently in AAR's representation of the railroad industry before a variety of government regulatory bodies. Including our participation in front of the STB, particularly on a regular basis in the cost of capital determinations. The cost indices and a number of other areas.

In the past, prior to coming to AAR I was in the rail industry directly for 27 years, both Class 2 and Class 1 railroads. Over half that time spent in the marketing organizations of those railroads. The rest of it in strategic planning, network planning and network management. And as an aside in that, I would mention that during those times in marketing, just to address very briefly an earlier question that has come up, in the course of thousands of pricing activities meeting with literally thousands of customers during that time, at no time did I ever or did anyone that reported to me, as far as I know, ever know what the URCS cost of a move was.

That simply was not something that was a part of what you did. It was, you were expected to work at the market and URCS cost was not used at all.

However, the purpose of my testimony here today is to address the proposal the WCTL has brought forward to substitute predecessor cost for GAAP acquisition costs in the BNSF acquisition for the purposes of revenue adequacy and URCS costing purposes.

First of all, note that GAAP acquisition cost is at this point required by the Board's rules. And the Board has applied these rules to merger and acquisition transactions since the late 1970's. And I would emphasize in that is both merger and acquisition transactions.

This is not the first time that the ICC or the Board's use of acquisition costs has been challenged. But when the agency's position's been challenged, whether by AAR as you have noted in the past, or by shipper groups, it has reached the same conclusion that GAAP acquisition cost is the right policy and the right rule for the railroad industry to follow.

It is not my intent in this testimony to discuss either, to refer to reports or decisions of the RAPB, the ICC or the STB or the courts on the issue. Quite frankly, the written record that's already in this proceeding already does that quite adequately.

Rather as someone who has had experience in conducting and supervising the economic, financial cost studies of the rail industry, and as I said have been involved in numerous negotiations on pricing in the rail industry and who in my current position needs to be mindful of the ways that management, investors and the STB and others use railroad data, I would like only to stress a few points in my testimony.

First, the Board should use the costs that are most economically accurate. You've heard this already today. But in fulfilling its regulatory obligations it's our belief that the economic accuracy of these costs is imperative.

Second, the Board should not deviate from applying the rules that are most economically accurate because of a particularly party's desired result. This has been the Board's policy in the past and should continue to be as we go forward.

And third, the Board should apply its rules evenhandedly in all merger and acquisition transactions. As the agency responsible for economic regulation of the rail industry, the Board should be trying at all times to use cost data insofar as it is practical that reflect current economic conditions.

In this regard GAAP acquisition cost

is economically superior to predecessor cost for railroads in merger and acquisition transactions. Because acquisition cost measures a railroad's current costs at the time of the transaction. In other words, it measures the ability of the assets that the railroad has in hand to produce value for its shareholders and for the rail entity going forward.

No one has argued in this case that the out of date predecessor costs would be more economically accurate than the GAAP acquisition cost. And they could not realistically do so. Even the arguments you've heard on accuracy have tended to be in terms of the accounting accuracy.

Again, as Professor Weil mentioned earlier, the real issue here is not the accounting accuracy, it's the economic accuracy. For example, as Mr. Hund testified earlier, the market value of the stock of BNSF at the time of the acquisition was already twice the book value before Berkshire purchased BNSF. And no one other than Mr. McBride's oral testimony a bit earlier, contends that the purchase price paid by Berkshire was not negotiated as an arms length transaction.

It is plain, quite frankly, that the market had already spoken long before the Berkshire transaction and that the book value of BNSF assets bore no meaningful relationship to their economic value. Again the economic value, their ability to produce future income streams.

The book value is similarly unrelated to the replacement costs of the assets. The values established the GAAP accounting process are unquestionably more accurate in these economic terms than are their predecessor values.

My second point is that the RAPB, the ICC and the STB, have consistently endorsed and applied GAAP acquisition costs based on a sound policy, not based on a desired result. The agency applied acquisition costs to transactions when railroads were purchased for less than book value because it determined that the acquisition cost more closely measured the railroad's current economic value, its current, its prospects looking forward.

I am not aware that the shippers objected to the use of acquisition costs in those circumstances. In fact, as we've noted today, there have been a number of cases in which they actively supported it.

The ICC and STB have also applied acquisition costs when railroads were acquired for more than book value. Again because the agency determined that the acquisition cost more closely related to the railroad's current economic value.

To the extent that certain shippers, parties now say that they don't like the acquisition cost in this transaction where the railroad is purchased for more than book value, quite frankly, you can't have it both ways. You have to have some level of consistency as Mr. Weicher pointed out and I believe Mr. Hund echoed, the market demands no less of a level of consistency.

Economic costs are economic costs regardless of who advocates what principles. And the Board's decisions should be driven by the most accurate economic data available. In this case the GAAP, the accounting based on the GAAP principles.

Finally, it is important to stress that the industry, investors and the public rely on consistency and predictability and evenhanded application of the Board's rules. The railroad's books are maintained for SEC reporting purposes as well as R-1 reporting purposes on the basis of GAAP purchase accounting.

Virtually every major railroad in the United States has been involved in a significant merger or acquisition transaction in the past 25 years, in some cases several merger and acquisition transactions over that period. And all these transactions have been handled under GAAP purchase accounting, including of course the one, Mr. Chairman, that you noted the Blackstone acquisition of CNW.

In asking for a suspension of GAAP accounting in the BNSF acquisition, WCTL is essentially asking the Board to reject the same financial principles to which financial institutions providing information to the public are consistently held. These principles, consistency and fairness in reporting and embedded in GAAP accounting.

These principles do not change based upon a particular party's desired outcome. Rather they demand the facts be reported in a transparent manner that markets and their participants, whether individual, institutional or public investors, can rely on the accurate economically sound representations for market values.

The Board should continue to apply its rules evenhandedly and uphold the acquisition cost principles just as it has consistently done in the past. Thank you and any questions?

CHAIRMAN ELLIOTT: Thank you, Mr. Gray. I don't have any questions. Vice Chairman?

VICE CHAIRMAN MULVEY: I just have one and that is the AAR represents all the railroads, all the Class 1 railroads and some of the larger regional railroads. Does allowing BNSF to write up the acquisition premium give it a competitive advantage vis a vis the other Class 1 carriers?

BNSF's write up values means its assets are measured using something far closer to replacement costs than the Board allows in other contexts. So is it appropriate for UP to be closer to revenue adequacy than BNSF simply because BNSF was able to take advantage of purchase accounting because it was acquired? Or should we find some ways to treat them all the same?

MR. GRAY: Again, I think it was put quite correctly earlier that we can't, you know, we can't allow the perfect to be the enemy of the good in this case. And quite frankly, there are certainly changes, but in the relative position of the companies because of this.

But the fact remains that all of these companies are making their decisions on how they approach the market on the basis of the market. And they are making those regardless of what their asset base valuation is.

The fact is that they are all looking at the market as to the opportunity that is available, not based upon some underlying financial basis. And when they're doing that, quite frankly, the end of year financial statement is not going to be based upon the regulatory value of the company. It is going to be based upon their performance in the market and their ability to attract customers within that market and price appropriately.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN ELLIOTT: You're off the hook. Okay. We'll call up our final panel, which has appeared before us before for rebuttal. I believe you have 15 minutes on rebuttal.

MR. LESEUR: Okay. Well it's been a long day with no breaks. So we'll try to keep it short and sweet here. I just wanted, I started out earlier today with, from an outline of our position and I just want to go through some of the points I made before just to see where we are.

The question that, you know, we raised initially and we think the fundamental question in this case is should BNSF's captive shippers pay higher rates simply because BNSF ownership has changed hands? And what I think we heard from the BN is basically the answer to that question is yes with some potential caveats to the deal with AEPCO and Western Fuels.

And they have a, their big picture is that most folks won't be injured. But the bottom line is their saying, yes. Rates should go up. And, you know, in going through our list we said, you know, there's no question Berkshire paid a premium to acquire BNSF and that for STB purposes it equals 8.1 billion.

There's been a lot of questions about, you know, the 8.1 billion in terms of is that a good number, a bad number. And one of the things we did in this case and I don't think it's in the record because we handled it with BNSF counsel, is we sent a letter to BNSF, we being Slover & Loftus in October 12, 2011, basically said, you know, we'd like to have the back up for the, you know, how you're coming up with the $42 to $9.9 million. How it was pushed down? How asset values were allocated based upon their respective fair market values?

And we were trying to get at some of this, the accounting reports. And we were told in no uncertain terms by Mr. Jenkins in a letter he sent to us on October 17, 2011, that we couldn't have those. So, as I said earlier you know, we basically, given what we were trying to do in this case we didn't get into whether that number was accurately calculated or not.

We just for the purpose of what we were doing here we were trying to get the premium out. It was secondary to what we're trying to do here how much it exactly was. So that was the decision we made there.

And on this, you know, a fairness point I think that the BN said today, I guess for the first time that, you know, there may be some synergies involved with this transaction. But I believe they said it wasn't enough to offset the premium. And, you know, I don't think they disagreed with the proposition that this premium will generate increased rates on some folks.

In terms of what other utility regulators are doing, I don't think the BN disagreed that no other public utility regulator in the country would permit the pass through of an acquisition premium on the facts presented in this case. They simply say that STB regulation is different.

And the point that we've been trying to make here is in the fundamental principle of protection of captive utility customers, that they shouldn't pay higher rates if their service hasn't changed. That principle applies across the board.

We also said we believe the Board has the legal authority to remove the premium for BNSF URCS. And, Mr. Chairman, I know you asked some questions about it. And I think, you know, the legal requirements are it is a case by case consideration we think under Section 10707 involves market dominance under Section 1 which involves maximum rate reasonableness.

The Board clearly has the authority to remove the premium from BNSF's URCS and from the net investment base for revenue purposes. And just to be clear here, we're not asking that the Board change its system of accounts.

We're not asking how BN does its regulatory accounting. What we're asking for is when the staff gets this information and develops an URCS, which is a Board product that's used in Board proceedings for very specific purposes, that the Board staff remove the premium.

We're not asking that a fundamental change in the Board's accounting rules in how the BN actually reports data to the Board.

There's a lot of discussion about uniformity.

We're talking here about asking the Board to take an action to evolve its costing system which is used for very specific purposes, principally to set rates in rate cases. And that's why we wanted to come out because of the adverse impact inclusion of the premium has on captive customers.

We're not asking for wholesale change in the way BN does its reporting, how the R-1's are put together or anything of that nature. You know, the BN also repeated today the same arguments its made, you know, in its briefs. It asks the Board to treat this case as an accounting case.

And we had pointed out that the DC Circuit had said there's no assurance that reasonable accounting measures translate automatically into reasonable rates. I didn't hear the BN object to that proposition. They just ignored it. And that's the proposition that we're raising before the Board today.

We've also heard a lot about precedent. And it's interesting to me having sat through so many major merger proceedings where the railroads would come in, including the BN, UP SP, Conrail, and the pitch before this agency was, let us merge.

We'll have, costs will go down. Customers will be benefitted in the form of reduced rates and we improve service. That was the reason why all these mergers were, generally speaking, approved. And we think the same thing was true with the acquisition of CNW.

You can get into all the weeds about who said what one, who said what when, but that's what was going on in these transactions. And that's what the Board said in Conrail. I didn't bring the Conrail decision with me, but we quote it in our papers where the Board said that's exactly why we've approved all of these mergers.

And our position basically is, and

those mergers had premiums, this case is different. And if you believe that the Board in those cases was approving these mergers in order to basically help consumers by reducing rates and improving service, this is a different animal. And that's our argument on why precedent should be distinguished.

We've also heard a lot about the impact on the, you know, the rates and the jurisdictional threshold. In Mr. Crowley's rebuttal testimony we put in, you know, percentages based on what percentage of regulated traffic would be basically removed.

And unfortunately that's a highly confidential number, which is why we didn't cite it today. But it's significantly larger than the, whatever the 2 percent of all of BNSF's traffic which includes exempt traffic.

And if you look at the portion of the traffic that's regulated we have figures in there. We also have figures showing that a very large percentage, again it's highly confidential, of BNSF's traffic base is subject to regulation by this Board because their rates are over 180 percent of variable costs.

We've also heard today and it's interesting to hear railroad, some of the railroad folks up here saying that, you know, URCS doesn't make, you know, any difference out in the commercial world. John Lannigan, who is one of the senior officials at BN, testified in this case, or actually in some other cases about how important URCS was.

Coal shippers and others are more sophisticated. If you're captive you go in and you try to negotiate a deal based upon URCS and other STB standards. And Mr. Lannigan has acknowledged that in other cases. And that's one of the reasons why the BN comes in here time and time again.

If your standards didn't make any difference, they wouldn't be in here talking about them. And, you know, I think another point which came up which was the impact on SAC and things like that, I'll let Mr. Crowley address. Because we put quite a bit of material in here trying to demonstrate that it does have a substantial impact.

You know, not just on past SAC cases, but could on future SAC cases. And also it has a tremendous impact on your three benchmark cases which use RSAM and as you roll in the higher RSAM figures as a four year average, you not only have one year that has the premium in there because you roll that in and then also apply it to a marked up base variable cost figure, you're going to see substantially higher numbers in these small rate cases.

And so while we represent large shippers and we're concerned about the impacts on them, one of the more fundamental impacts of all this will be on the small shippers. And I mentioned at the outset if you have a case where you only have a million dollars worth of relief, you're not going to be able to get in and start arguing the way we have here about removing the premium.

MR. CROWLEY: One of the things that we heard a lot this morning from the BNSF, was the words not a big impact. That was repeated over and over again and it was never followed by any numbers or quantification of what not a big impact means.

I won't go over the stuff that we presented already or that's included in the written evidence other than to say that we have numerous examples of the impact on the MMM process and the SAC and simplified SAC approaches. I would suggest that in simplified SAC you actually use URCS to make some calculations.

And then in the three benchmark cases we've shown examples of where virtually 70 percent of the relief can be gone over the five-year period. One thing I'd like to mention or maybe remind the Board of is, when the Board or the ICC I guess it was, transitioned from Rail Form A to URCS, probably haven't heard Rail Form A in a few years, they created a linking factor. Because they were concerned about the amount of regulated traffic that would go away by adopting URCS because it calculated costs slightly differently.

Now that's something that you could certainly implement here if you're in favor of such a linking factor. It would take care of at least the jurisdictional threshold side of the issue. The revenue adequacy side could be taken care of by a simple deduction to net investment. I think the solutions are relatively straightforward if you're buying our position.

MR. WILSON: What struck me in listening to the BNSF arguments was how much of what they had to say was, I think, beside the point that the Board should be focusing on in this case. What is the point? The point seems to me is what are fair rates for captive shippers. The point is not market valuation or stock value. The point's not market forces setting prices.

Captive shippers don't have the benefit of market forces setting prices. And it's quite different for them than it is for apparently the bulk of railroad shippers. So what's fair about double compensation for inflation both through acquisition premiums and through nominal rates of return? It doesn't seem to me that that's reasonable or fair and regulars that I know would not tolerate that.

What's fair about providing captive customers less protection than is provided for customers that have the benefit of competitive protections? Regulation exists for the purpose of giving captive customers some of the protections that competition provides in competitive markets.

Competition would never permit

double compensation for inflation. Competitive markets wouldn't tolerate it. Competitive markets would never permit raising rates simply because of changes in ownership if there's no increase in benefits. If there's no increase in efficiency, if there's no reduction in costs, competitive markets wouldn't reward with higher prices.

So what is being suggested here by BNSF is not only inconsistent with what happens in competitive markets, that is the protections that are provided for captive shippers, but I think that an awful lot of the discussion, an awful lot of the argument has strayed very far from what the Board's central focus should be. And that's the protection to captive shippers.

CHAIRMAN ELLIOTT: Thank you. Vice Chairman.

VICE CHAIRMAN MULVEY: Thank you. A couple of brief questions. You mentioned about the size of the impact and I asked a question and I didn't follow my notes. I asked about, they mentioned 2 percent and I said 2 percent of what?

Well the other part of that is 2 percent of the regulated traffic or 2 percent of the total traffic? And you accurately mentioned it was 2 percent of the regulated traffic that is a lot greater percentage, a lot more of an impact.

But basically I think we hear from both sides that this is basically an all or nothing problem. Either we follow GAAP or we do not follow GAAP. And it was suggested that perhaps there was some way of phasing it in. And we didn't really get any warm and fuzzy responses to that from either side.

Your side basically said no. The other side basically said we'd rather not. So it does strike me that we are going to have to decide this either to accept the GAAP or to reject it and go to book value of the assets. Would you agree with that? That it's basically one way or the other. Or could you see some way of splitting the baby?

MR. WILSON: I would suggest that you focus a little bit more than some of the arguments have suggested on what the purpose of the valuation is. I think there's no question that market value, the price that's paid for common stock is the best measure of the market value of common stock at that particular moment in time. And that's subject to change over time.

On the other hand, if you want the best measure of the investor's contribution of the investors, what the investor has dedicated to public service, certainly book value is very relevant. And that argument was made earlier that I think is absurd.

That somehow valuing on the basis of the present value of stock is somehow less risky to investors than guaranteeing them a return and a recovery of their capital, including an inflation allowance on the actual investment that was made, the book value. That's, I don't know how much financing some of the other folks here have done, but certainly if you go to the investment community there's nothing that's lower risk than providing for the recovery of capital and a return on that capital that the investor has put up.

And that's not the present value of common stock. The present value of common stock to an economist is of course an important measure, but it's not necessarily the measure that ought to be used for this type of a regulatory determination.

MR. CROWLEY: Let me talk about the 2 percent for just a second. The 2 percent that I calculated this morning was the impact on Western Fuels, what the base for their example. It wasn't an indication of how much traffic was impacted because of this transaction.

VICE CHAIRMAN MULVEY: I was

referring to their 2 percent, not your 2 percent.

MR. CROWLEY: Okay. Thank you.

VICE CHAIRMAN MULVEY: At the beginning I said there's two basic issues here to decide on the impact of this on rates versus also what is the theoretical, proper way of accounting, no pun intended. Do you think the Board should focus on the impact or should it focus on the, what is the correct way of handling, the theoretically correct way of handling the purchase?

MR. CROWLEY: I would think they would go hand in hand. Hopefully they would. But obviously we have a, we're at a crossroads here. How do you ignore the impact on a group of shippers? I mean, how do you condone letting rates increase because of this transaction?

It just seems like it's very straightforward. This is a very unique situation. It's never happened before. I don't think you need to be, follow some strict set of conditions that happened where circumstances were different. I think you can handle this differently. And I think Mr. LeSeur has given you plenty of authority to do that.

VICE CHAIRMAN MULVEY: We have the authority to make a decision here one way or the other. I don't think we are precluded from going one way or the other and that's obviously something we'll have to be considering.

CHAIRMAN ELLIOTT: Just one last question. In Mr. LeSeur's reading of the law states that we're looking at these things on a case by case basis. And you mentioned this is a very unique circumstance.

And if we are looking at it on a case by case basis and we take in mind BNSF's consideration of consistency with respect to our regulation, it kind of brings me back to my idea of phasing in the premium with, keeping in mind the comments made by Mr. Hund regarding time period and having a proper basis for it.

And that would seem like here maybe an ideal way to keep the consistency going and also deal with some of these equitable issues that you have raised today with respect to revenue adequacy and threshold. Now I don't know technically if all of this is possible.

But I wonder after hearing BNSF's warm embrace of my concept, for the record, that was a joke. But I would say begrudgingly acknowledging it, if you have any further thoughts on that?

MR. LESEUR: What do you mean by phasing it in? 25 percent of the year or something until it's all phased in, are we phasing it out? What are we doing?

CHAIRMAN ELLIOTT: No. We would be phasing it in.

MR. LESEUR: Phasing it in. Because it's already in there now so you would --

CHAIRMAN ELLIOTT: Well, we're acting as if we're starting from ground zero, I guess.

MR. LESEUR: Right. So under that proposal you would have, assuming it's, the write up is 8 billion, you'd have 2 billion in year one, 4 billion in year two and you'd phase it in that way?

CHAIRMAN ELLIOTT: That would be the general idea.

MR. CROWLEY: So we take the 8 billion out and start from our base and put 2 billion in a year.

MR. LESEUR: I don't see over the long term how that would provide much protection to captive shippers, particularly dealing with the ten-year prescription you're going to be using in URCS where you're phasing it in. So I think that's why you haven't seen a real warm and, if you're going to phase it out. Since it's in right now, if you phase it out over a four-year period then that might be something that we would.

CHAIRMAN ELLIOTT: I've never heard that legal concept before. But --

MR. WILSON: I would think that if you're going to do something like a phase in it would be important that the phase in be capped by increases in rates in the competitive market so that captive shippers are not the only ones that are being stuck with the acquisition premium.

I think that anything that involves a phase in should certainly cap the phase into what is being seen on the competitive market side so that the captive shippers are not abandoned completely on this question of the double compensation and so on.

CHAIRMAN ELLIOTT: I have nothing further. Thank you all for coming today and being so patient working through all day without a break. That's greatly appreciated. And we'll take this matter under advisement and the meeting is now, the hearing is now adjourned. Thank you.

(Whereupon, the hearing in the above-entitled matter was concluded at 2:33 p.m.)

J

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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 my direction; further, that said transcript is a true and accurate record of the proceedings.

Neal R Gross

Court Reporter

232132

Finance Docket No. 35506: WCTL Petition

Surface Transportation Board Public Hearing

March 22, 2012

BNSF RAILWAY

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

BNSF RAILWAY

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

BNSF RAILWAY

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 <u>market value</u> of stock recorded to Goodwill

BNSF RAILWAY

Valuation Process

- Role of Ernst & Young
- Audited by Deloitte & Touche
- Duplicative assets not considered
- Low point in economic cycle

Purchase Price Allocation

BRK Acquisition Price	$35B
BNSF Historical Book Value	-$13B
Purchase Price in Excess of Historical Book Value	$22B

Source: Hund Verified Statement (BNSF Opening), p.6

Purchase Price Allocation

BRK Acquisition Price	$35B
BNSF Historical Book Value	-$13B
Purchase Price in Excess of Historical Book Value	$22B
Net Assets Affecting BNSF Regulatory Costs	$8B
Goodwill - No Affect on BNSF Regulatory Costs	$14B
Total	$22B

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

BNSF RAILWAY

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

BNSF RAILWAY

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[1] Implied by the Market		$5	
Goodwill[1] Implied by BRK Premium over Market			$9
Total Goodwill[1] Write-up		$14	

[1]Goodwill is $15 billion of net liabilities not affecting BNSF Railway regulatory costs.

Source: Hund Verified Statement (BNSF Opening), p.8

BNSF RAILWAY

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)

BNSF RAILWAY

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

BNSF RAILWAY

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.

BNSF RAILWAY

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[1]

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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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[1]

Decided July 20, 1998

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."

STB FINANCE DOCKET NO. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.,
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
—CONTROL AND OPERATING LEASES/AGREEMENTS—
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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."

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

www.brattle.com

Antitrust/Competition Commercial Damages Environmental Litigation and Regulation Forensic Economics Intellectual Property International Arbitration International Trade Product Liability Regulatory Finance and Accounting Risk Management Securities Tax Utility Regulatory Policy and Ratemaking Valuation Electric Power Financial Institutions Natural Gas Petroleum Pharmaceuticals, Medical Devices, and Biotechnology Telecommunications and Media Transportation

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.

BNSF RAILWAY

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 RAILWAY

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 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,

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

	Amount (Millions)		
Merger (1)	**Projected Cost Synergies Per Year** (2)	**Acquisition Premium** [1/] (3)	**Years to Recover Premium** [2/] (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	~

[1/] Net premium included in URCS.
[2/] 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)

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WRITER'S E-MAIL:

October 12, 2011

VIA EMAIL AND U.S. MAIL

Robert M. Jenkins, III
Mayer Brown LLP
1999 K Street, NW
Washington, DC 20006

Re: 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.

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,

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 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,

Robert M. Jenkins III

cc: Jill K. Mulligan