

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

WESTERN COAL TRAFFIC
LEAGUE – PETITION FOR
DECLARATORY ORDER

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) Finance Docket No. 35506
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**JOINT REPLY EVIDENCE AND ARGUMENT OF 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.**

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The Western Coal Traffic League ("WCTL"), American Public Power Association, Edison Electric Institute, National Association of Regulatory Utility Commissioners ("NARUC"), National Rural Electric Cooperative Association, Western Fuels Association, Inc. ("WFA"), and Basin Electric Power Cooperative, Inc. ("Basin Electric") (collectively "Coal Shippers/NARUC") present the following Joint Reply Evidence and Argument in support of WCTL's May 2, 2011 Petition for a Declaratory Order ("WCTL Petition").

PREFACE AND SUMMARY

In their Opening Evidence and Argument ("Coal Shippers/NARUC Op." or "Opening Evidence"), Coal Shippers/NARUC emphasized that this case raises a fundamental regulatory question: whether shippers that are captive to BNSF Railway Company ("BNSF") should pay higher rail rates simply because BNSF's ownership has

changed hands. Coal Shippers/NARUC have fully demonstrated the need for the issuance of a declaratory order by the Board in this instance to exclude the largest railroad acquisition premium ever, totaling \$8,100,000,000, from BNSF's Uniform Railroad Costing System ("URCS"), starting in 2010, and to exclude the premium in calculating BNSF's net investment base for revenue adequacy purposes. Nothing BNSF has said in opposition overcomes that demonstration.

Support for WCTL's Petition is widespread amongst shippers of all major commodities. To date, including Coal Shippers/NARUC, a total of 21 shippers or associations of shippers and NARUC, representing the collective interests of State utility commissions, have weighed in and presented opening evidence. All of these shippers support WCTL's petition. *See* Opening Comments of Alliance for Rail Competition, Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Montana Farmers Union, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producer Board, Washington Grain Commission, and National Association of Wheat Growers; Opening Evidence and Argument of National Corn Growers Association; Opening Argument of The National Industrial Transportation League; and Opening Evidence and Argument of Consumers United for Rail Equity.

The U.S. Department of Agriculture ("USDA") also filed opening comments in strong support of WCTL's Petition, confirming that the potential impacts raised by the BNSF acquisition premium are widespread, "adversely affect the rail and

electricity rates for rural America and farmers, and [that the pass-through of the BNSF acquisition premium] should not be allowed.” USDA Opening Comments at 3.¹

BNSF filed opening comments in opposition. *See* Opening Evidence and Argument of BNSF (“BNSF Opening” or “BNSF Op.”). A short statement in support of BNSF’s position was also filed by the Association of American Railroads (“AAR”). *See* Opening Comments of AAR. In its opening comments, BNSF finally *fully acknowledges* the enormous size of the acquisition premium involved, which for Surface Transportation Board (“STB”) regulatory costing purposes approximates \$8,100,000,000. BNSF also acknowledges that, under current regulatory practice, the accounts making up this total are included in BNSF’s 2010 R-1 and unless the Board declares otherwise, will be included in BNSF’s 2010 URCS data set. *See* BNSF Op. at 20; Verified Statement of Michael R. Baranowski and Benton V. Fisher (“Baranowski/ Fisher Op. V.S.”) at 3-4. BNSF further acknowledges that, once included in BNSF’s URCS, the premium-infused accounts will increase BNSF’s variable costs, which will then be used to determine the Board’s regulatory jurisdiction, and a captive shipper’s maximum rates in every case brought before the Board where BNSF is a defendant. BNSF Op. at 20-22; Baranowski/Fisher Op. V.S. at 3-6.

¹ Additionally, the U.S. Department of Transportation (“USDOT”) filed opening comments without taking a definitive position on WCTL’s Petition, stating that it “may offer additional views at a later stage in the proceeding after considering comments made by other parties.” USDOT Opening Comments at 6.

While acknowledging the \$8.1 billion premium amount, BNSF still attempts to downplay its significance. BNSF engages in several misleading verbal gymnastics in an attempt to “hide the ball” – contending that not many shippers will be impacted by the premium pass-through, and even impacted shippers will not be harmed significantly since the premium amount is “only \$8 billion.” BNSF Op. at 3, 20. BNSF and AAR also each insist that “settled precedent” and Generally Accepted Accounting Principles (“GAAP”) require the Board to permit the acquisition premium to flow through to BNSF ratepayers in this instance, and without any critical review by the Board. *Id.* at 4-12.

For the most part, the points BNSF attempts to make in defense of its attempted premium pass-through are points that BNSF already made in its May 23, 2011 Reply to WCTL’s Petition. Coal Shippers/NARUC fully addressed these contentions in their Opening Evidence and Argument, and will not repeat that exhaustive presentation here. Coal Shippers/NARUC’s Reply Evidence and Argument focuses principally on new contentions BNSF presented for the first time in Opening, including the following:

- BNSF contends that its attempted premium pass-through is proper because it is seeking to allocate “only \$8 billion” to its regulatory rate base, intimating that it could have sought to include much more into its rate base – with additional amounts allocated to goodwill. BNSF Op. at 3. However, captive shippers, NARUC, USDA, and 11 United States Senators who are participating as parties in this proceeding or who have submitted comments are not concerned about what BNSF *has not* allocated

to BNSF's rate base: they are concerned about the substantial amounts BNSF *has* allocated to the rate base: \$8.1 billion. In any event, BNSF clearly allocated every last penny to the rate base it believed it was entitled to under GAAP, and BNSF has taken no steps to minimize or eliminate this attempted regulatory pass-through as part of its accounting practices. BNSF's goodwill arguments are a diversionary tactic, are highly misleading and irrelevant, and ignore the elephant in the room: the \$8.1 billion which BNSF is attempting to allocate to the rate base and pass-on to captive shippers.

- BNSF further contends that its actions were proper because while it was paid \$100 per share by Berkshire for the acquisition, all dollars in excess of \$76 per share (the stock market price immediately prior to purchase) are to be excluded from BNSF's URCS costs. *Id.* BNSF's per share price discussion, like its goodwill discussion, is also highly misleading and off-base. Again, BNSF has *done nothing* to minimize or eliminate the premium impacts. BNSF's goodwill and share price discussions are simply red herrings and a feeble attempt by BNSF to divert the discussion away from its attempted substantial \$8.1 billion premium pass-through to captive shippers.

- BNSF also asserts that its "policy and practice" is to establish rates "on the basis of market demand, not regulatory costs," and, as a result, the premium "will not result in increases to BNSF's rates." *Id.* at 4. BNSF's "no customer impacts" assertion is belied by the testimony of 21 shippers and shipper groups, NARUC, and USDA – along with 11 U.S. Senators – who all believe that the premium will have real

and substantial market and regulatory impacts on captive shippers. BNSF's made for litigation. "market based rates" contentions are clearly erroneous and misleading, and are contradicted by recent BNSF statements to the Board that its regulatory costs have a substantial impact on BNSF rate setting.

- BNSF further asserts that the attempted pass-through of an \$8.1 billion premium to captive shippers should raise very little or no regulatory concern as it will only have "modest" effects on BNSF's URCS and on revenue adequacy and in any event, few shipper rate complaints are filed that bring URCS into play. These additional "no harm, no foul" contentions are erroneous and stand at direct odds with recent strong statements from the Board, BNSF, other railroads, and the AAR on the increasingly important role of URCS costs to the Board's regulatory proceedings, the large number of cases that are affected, and the real and substantial regulatory impacts that arise even when relatively modest dollar amounts are added to a railroad's URCS. Additionally, no railroad has been involved in more rate cases at the Board than BNSF in recent years, cases where URCS costs matter.

Coal Shippers/NARUC also address below certain BNSF mischaracterizations of the legal standards involved, the type of relief WCTL is requesting, and how the law should be applied in this case.

Finally, to ensure that Coal Shippers/NARUC's position is clear, and that there are no misunderstandings, it is important to reemphasize up front what this proceeding is about, and what it is not about:

First, this case is about fundamental fairness: should captive shipper rates increase – automatically – simply because Berkshire paid an acquisition premium to acquire BNSF, and whether captive shippers and their customers should have to pay more simply because Berkshire paid a premium to purchase BNSF.

Second, this case is about a *real* acquisition premium affecting *real* shippers. Despite BNSF's repeated attempts to hide its \$8.1 billion premium from regulatory scrutiny, this number is real, not phantom, and is the only number that matters here.

Third, this case is not about whether Berkshire Hathaway paid too much (or too little) for BNSF's assets, or the methodology it used to value purchased assets. The law does not require that shippers make a showing on whether the price paid by Berkshire was *bona fide* or not. As Coal Shippers/NARUC stated on Opening, they "commend Mr. Buffett on making a good deal for himself and other Berkshire shareholders. They simply ask that this good fortune for the new owners of BNSF does not directly translate into misfortune for captive BNSF customers in the form of rates that are increased solely because the ownership of BNSF changed hands." Coal Shippers/NARUC Op. at 2.

Fourth, this case is not about GAAP or any other accounting rule, and whether BNSF properly followed GAAP rules here. No one is disputing that GAAP acquisition accounting applies to how the BNSF acquisition was recorded on BNSF's financial statements. However, GAAP does not require the automatic pass-through of

premium-generated rate increases to its captive customers. The Board is charged with setting maximum reasonable rates and the Board's current maximum rate standards rely on costs in setting those rates. Costs used to develop maximum rates must be calculated in a manner consistent with the overriding Congressional intent that the Board exercise sound judgment and protect the public interest. As long recognized by the courts, "it is rates, not bookkeeping that [the Interstate Commerce Act] requires to be reasonable, and there is no assurance . . . that reasonable accounting measures translate automatically into reasonable rates." *Farmers Union Cent. Exch. v. FERC*, 584 F.2d 408, 418 (D.C. Cir. 1978). This point is even more important today than ever, because, as explained herein, URCS costs have an increased importance and a significant role in a range of rate regulatory proceedings – which was not the case 25 years ago, or even 5 years ago.

Fifth, this case is not about singling BNSF out for disparate treatment or applying the *results* of case law precedent as applied in different mergers with vastly different facts. Berkshire's acquisition of BNSF is materially different than past mergers that have come before the Board, and BNSF has made no serious attempt to show any such purported similarities. The Board has approved prior rail mergers involving premiums on grounds that the mergers would inure to the shipping public's benefit in the form of reduced costs and rates (brought about by merger synergies). Unlike those transactions, Berkshire's acquisition of BNSF brings about only premium-generated increased regulatory costs and increased rates for captive shippers. Also, unlike prior

mergers. Berkshire's acquisition of BNSF was not one approved by the Board and it involves a far larger premium amount than those involved in prior mergers.

Sixth. this case is not about attempts to establish new binding acquisition premium rules applicable to all future rail merger or acquisition transactions. and WCTL's Petition does not seek the establishment of any such new rules. WCTL simply asks the Board to apply its existing authority and legal precedent to the facts of *this* transaction and, after doing so, make a decision to remove the premium from BNSF's rate base and for purposes of determining revenue adequacy. Any future railroad merger or acquisition would likewise be determined under the same rules should an acquisition premium issue be raised in that proceeding. and should any party seek to challenge any attempted premium pass-through.

Seventh. this case is about the STB's clear authority to protect the public interest by exercising its statutory authority to adjust BNSF's URCS variable costs to remove the acquisition premium for purposes of determining and applying its maximum rate jurisdiction over captive rail traffic and to remove the premium from the investment base the Board utilizes to calculate BNSF's revenue adequacy. This action will ensure that captive BNSF customers' rates will not be higher simply because Mr. Buffett decided that Berkshire should acquire BNSF and pay an acquisition premium to do so. Also, removal of the premium is not unfair to BNSF or Berkshire's shareholders. Granting this relief is consistent with basic notions of regulatory fairness, and basic principles of rate regulation employed by all other federal and state regulators. BNSF can continue to earn

handsome rewards from Mr. Buffet's investment. Granting this relief simply prevents unfairly gouging shippers who have no choice but to utilize BNSF's services.

ARGUMENT

I.

BNSF'S MISGUIDED ATTEMPTS TO DOWNPLAY THE IMPACT OF THE \$8.1 BILLION PREMIUM ON ITS CAPTIVE CUSTOMERS

BNSF was acquired by Berkshire Hathaway over 21 months ago on February 12, 2010. *See* Statement of Thomas N. Hund ("Hund Op. V.S.") at 2. BNSF submitted to the Board its 2010 R-1 on or around March 31, 2011. On May 2, 2011, WCTL filed its Petition, and in that Petition, demonstrated that, left unchecked, for regulatory costing purposes the Berkshire acquisition of BNSF would produce a \$7.625 billion write-up in BNSF's net investment base and would decrease BNSF's annual depreciation charges by \$49 million. *See* WCTL Petition at Attachment 2. After receiving additional workpaper information from BNSF, the premium number was revised by Coal Shippers/NARUC to approximately \$8.1 billion. The \$8.1 billion premium calculation was fully documented in Coal Shippers/NARUC's Opening exhibits and workpapers. *See* Coal Shippers/NARUC Op. at 11-14.

BNSF has been attempting to ignore or direct attention away from the total amount of the premium involved since public questions were first raised about the premium following the Berkshire acquisition. For example, BNSF did not include anywhere in its May 23, 2011 Reply to WCTL's Petition its estimation of the amount of the premium, although it did not dispute WCTL's figures. Faced with the undisputed

facts of the regulatory acquisition premium amount, BNSF finally admits on Opening that the regulatory acquisition premium approximates \$8.1 billion. *See Hund Op. V.S. at 6; Baranowski/Fisher Op. V.S. at 2.*

Having been forced to admit on Opening the enormous and unprecedented \$8.1 billion size of the premium, BNSF not surprisingly attempts to draw attention away from the vast premium amount through a variety of diversionary arguments. BNSF's attempts to brush off the consumer and regulatory impacts are clearly off-base and misleading, and are easily discounted.

A. BNSF Took No Steps to Eliminate or Minimize the Attempted Premium Pass-Through

BNSF asserts that this transaction "differ[s]" from past merger transactions in two major respects. BNSF Op. at 3. First, BNSF asserts that in past mergers where acquisition accounting was followed, "most or all of the acquisition cost was allocated to the railroads' net investment base for regulatory purposes" (BNSF Op. at 3), whereas in Berkshire's acquisition of BNSF, \$14 billion was assigned to "goodwill and other items that do not affect regulatory costs" (Hund Op. V.S. at 4). BNSF further asserts that, on the day of the Berkshire acquisition, BNSF's stock was trading at \$76 per share, and that "every dollar paid by Berkshire Hathaway in excess of that \$76 per share market price was attributed to goodwill, and had no effect at all on BNSF's regulatory asset base." Hund Op. V.S. at 6. The clear – and misleading – implication BNSF is attempting to make with its "goodwill" and "per share price" contentions is that BNSF did not write up its assets as much as it could have, that it was acting conservatively, etc.

1. BNSF Red Herring # 1, Goodwill Allocation

The fact that BNSF followed GAAP acquisition accounting standards, as it was required to do, which resulted in part of the purchase price being allocated to goodwill, is hardly surprising, and in fact is expected and required. This is precisely what is supposed to happen in a business acquisition. As confirmed by Coal Shippers/NARUC's acquisition accounting expert Dr. Verrecchia:

Under GAAP, all business combinations initiated after December 15, 2008, are accounted for using the acquisition method, with all identifiable assets acquired or liabilities assumed of the acquired company recorded at their fair values at the acquisition date. *If the cost of the business combination exceeds the acquired company's identifiable assets at fair value net of the liabilities assumed at fair value, one assigns the excess to goodwill.*

Verified Statement of Robert E. Verrecchia ("Verrecchia Op. V.S.") at 2 (emphasis added).

BNSF's Mr. Hund confirms that under governing GAAP "purchase accounting" rules, BNSF was required to reflect all its assets and liabilities at "'fair value' as of the transaction date," with "[a]ny excess of purchase price over the 'fair value' of assets and liabilities . . . allocated to an intangible asset called goodwill." Hund Op. V.S. at 2-3. Mr. Hund further confirms that, in following GAAP, "some of BNSF's assets were written up while others were written down." *Id.* at 5. Mr. Hund explains that this was done only after BNSF's outside auditors "conducted a rigorous review of BNSF's physical and intangible assets and liabilities to determine a 'fair value' of the assets and liabilities in accordance with [GAAP acquisition accounting]." *Id.* at 4. The

result of this GAAP accounting exercise, says BNSF, is a regulatory purchase premium of \$8.139 billion which BNSF is attempting to “include[] in BNSF’s net investment for URCS purposes.” *See* Baranowski/Fisher Op. V.S. at 2; *accord* Hund Op. V.S. at 6.

As Dr. Verrecchia explained on Opening, the fact that the fair value acquisition accounting evaluation here resulted in an \$8.1 billion asset write up with other transaction amounts allocated to goodwill is expected and “common[]” under the acquisition method:

A central feature of the acquisition method is that all identifiable assets acquired, liabilities assumed, or noncontrolling interest of the acquired company be recorded at their fair values at the acquisition date. Companies generally retain independent appraisers and valuation experts to determine fair values, although GAAP does provide some guidance. After assigning fair values to all identifiable assets acquired and liabilities assumed, one compares the investment cost with the identifiable assets at fair value net of the liabilities assumed at fair value (i.e., net fair value). If the investment cost exceeds the net fair value of the acquired company – which is commonly the case – one assigns the excess to an account that is referred to as “goodwill.”

Verrecchia Op. V.S. at 4 (citation omitted). BNSF says it valued its assets at “fair value” under GAAP acquisition accounting and no one is arguing that BNSF failed to apply acquisition accounting principles to the Berkshire acquisition.² As Dr. Verrecchia confirms, a normal and expected result of this accounting exercise, as with any business acquisition, is to apply any excess over “fair value” *automatically* to goodwill.

² BNSF confirms in its Securities and Exchange Commission and STB annual reports that GAAP acquisition accounting was utilized with the acquisition. *See* BNSF 2010 Annual Form 10-K at 25; BNSF 2010 R-1 at 9.

BNSF's assertions about goodwill are unremarkable and a clear red herring. In fact, even a cursory review of Berkshire Hathaway-controlled businesses reveals that goodwill is accounted for and permeates all of Berkshire's major businesses, including in its insurance businesses, its utilities and energy businesses, and its financial and financial products businesses. *See, e.g.* Berkshire Hathaway 2010 Annual Form 10-K at 61. For example, in 2010, Berkshire's balance sheets show that for Berkshire's insurance, manufacturing, and retail businesses, property, plant and equipment totaled \$15.7 billion and goodwill totaled \$27.9 billion. *Id.*

Clearly BNSF did not pay any specific attention to shippers or their concerns at all when engaging in acquisition accounting.³ Instead, as Mr. Hund confirms, under this accounting practice BNSF "conducted a rigorous review of BNSF's physical and intangible assets and liabilities to determine a 'fair value'," with every last penny that BNSF believed it was entitled to allocate to an identifiable asset being so allocated, and with all remaining excesses to identifiable assets above "fair value" automatically being allocated to goodwill.

BNSF is attempting to include 100% of its \$8.1 billion premium in its rate base. Coal Shippers/NARUC's Opening Evidence clearly shows that this amount dwarfs

³ Also, other than make very general assertions attempting to differentiate itself from past railroad merger or acquisition transactions, BNSF does not provide any specific evidence on how and why other mergers complied or did not comply with GAAP acquisition accounting, nor does BNSF identify any specific steps it took in this case, as compared to steps taken by railroads in other cases, to minimize asset write ups and maximize goodwill allocations.

recent western merger premiums and, in fact, approximates the total net acquisition premiums of the *three* most recent major western railroad merger transactions *combined*. Coal Shippers/NARUC Op. at 34, Verified Statement of Thomas D. Crowley and Daniel L. Fapp (“Crowley/Fapp Op. V.S.”) at 29. Captive shippers. NARUC, USDA, and 11 United States Senators who are participating in this proceeding care about what BNSF *has* allocated to the rate base, not about what BNSF *has not* allocated to the rate base. These parties are concerned about the enormous \$8.1 billion premium which BNSF is attempting to allocate to its rate base and pass-on to consumers, and it is clear that BNSF has taken no steps to minimize or eliminate this attempted regulatory pass-through.

2. BNSF Red Herring # 2, Share Price Allocation

BNSF’s share price discussion, like its goodwill discussion, is highly misleading and off-base for similar reasons. As BNSF states in its Opening Evidence, in its SEC financial reports, and in its 2010 R-1, BNSF engaged in acquisition accounting, and the net result was an \$8.1 regulatory acquisition premium. BNSF Op. at 6, Baranowski/ Fisher Op. V.S. at 2. Under acquisition accounting, BNSF wrote all of its identifiable assets up to their full fair value. Clearly Berkshire and BNSF did not engage in “share value accounting” they engaged in “purchase accounting[.] a technical accounting and regulatory practice.” Hund Op. V.S. at 4. If Berkshire or BNSF had engaged in any other practice in an attempt to minimize the premium amount, surely this fact would have been reported in their SEC financial statements and in BNSF’s 2010 R-1, but it was not.

BNSF's share price discussion, like its goodwill discussion, is simply a feeble attempt by BNSF to divert the discussion away from its attempted substantial \$8.1 billion premium pass-through to captive shippers. The Board should not and cannot ignore the elephant in the room: the \$8.1 billion which BNSF is attempting to allocate to the rate base and pass-on to consumers.

B. The Premium Will Result in Increased "Market" Rates for Captive Customers

BNSF asserts that the premium "will not result in increases to BNSF's rates" because BNSF's "policy and practice is to set transportation rates on the basis of market demand." BNSF Op. at 4; *accord* Hund Op. V.S. at 8 ("I do not believe . . . assertions [that customer rates will be impacted] to be correct" since it is "BNSF's policy and practice . . . to set its rates based upon market demand, not costs."). BNSF asserts that, because the premium pass-through will "not directly translate into BNSF imposing any rate increases," BNSF customers will not "be forced to pay for the acquisition through higher rates as a result of the application of purchasing [sic] accounting" Hund V.S. at 8-9. Coal Shippers/NARUC addressed this issue on Opening (*see* Coal Shippers/NARUC Op. at 17, Crowley/Fapp Op. V.S. at 25-26), and BNSF's further contentions are easily dismissed.

As the Board knows, the agency has *encouraged* shippers and carriers to utilize the Board's maximum rate standards to resolve rate disputes through commercial

negotiation.⁴ In this respect, the ICC and the STB have viewed their maximum regulatory rate standards and their jurisdictional threshold as commercial tools that would facilitate negotiated solutions to potential disputes before they even reached the agency.

In past STB proceedings, BNSF's Chief Marketing Officer has strongly asserted that regulatory costs *do matter* in rate setting, and that BNSF "has often" adjusted its rates on the basis of regulatory costs:

BNSF must consider the large amounts of revenue at risk when it makes pricing decisions. Coal shippers are sophisticated customers of rail transportation service. They regularly threaten to file rate litigation in our contract discussions in an effort to obtain rate concessions. BNSF has taken these threats seriously. . . . BNSF has often sought to avoid the substantial risks of litigation by agreeing to reduced rates in contract negotiations.

Statement of John P. Lanigan, STB Ex Parte No. 657, *Rail Rate Challenges Under the Stand-Alone Cost Methodology* (Public Hearing Testimony filed Apr. 20, 2005), at 3.

BNSF's assertions on Opening that BNSF rates are established exclusively by "market demand" with regulatory costs having no impact are belied by its Chief Marketing Officer's past unequivocal assertion to the Board to the contrary. *See also id.* Statement of BNSF regulatory counsel Samuel M. Sipe, Jr., at 2 ("case-by-case litigation of rate

⁴ The ICC took pains to point out in *Coal Rate Guidelines* that a benefit of the guidelines is to enable both the shipper and the railroad to estimate the maximum rate the agency would prescribe if the matter were brought before it for adjudication. *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 524 (1985) ("We believe that this will encourage contract solutions which . . . may often be more efficient and more beneficial to both parties than a prescribed rate.") ("*Coal Rate Guidelines*").

challenges under the *Guidelines* has produced standards that . . . limit the railroads' ability to set demand-based prices").

As BNSF has asserted to the Board elsewhere, captive shippers frequently invoke the Board's standards in their commercial negotiations with their rail carriers. Premium-infused increases in BNSF's variable costs thus not only impact litigation, they also impact commercial negotiations, since the maximum rate floors used in these negotiations increase just as they would in actual litigation between BNSF and its shippers. *See Crowley/Fapp Op. V.S. at 25-26.*

C. The Premium Will Have Consequential Regulatory Impacts

BNSF makes the remarkable assertion that, "out of thousands of BNSF customers and hundreds of thousands of contract and common carrier rates," since few shippers challenge rates, "it will be rare that any shipper's rates could be affected by the change in BNSF's net investment base." *Hund Op. V.S. at 9.* While BNSF admits that there is one current shipper directly impacted, WFA/Basin Electric, BNSF blithely asserts that the Board can "directly address those rare situations rather than alter over two decades of precedent and change its policies." *Id.*

As discussed by Coal Shippers/NARUC further herein, and on Opening, contrary to BNSF's assertions, WCTL's Petition does not ask the Board to "alter over two decades of precedent and change its policies." Instead, Coal Shippers/NARUC are asking the Board to apply existing law to the unique facts of this case and remove the acquisition premium from BNSF's URCS in this instance because it is fundamentally

unfair for captive shippers' rates to increase due solely to BNSF's change in ownership. Also, the impacts are not limited to only one shipper.

On Opening, Coal Shippers/NARUC fully addressed the fact that the regulatory impacts of the premium pass-through are not isolated as BNSF suggests, but are widespread, both in terms of affecting the STB's jurisdictional threshold and ratemaking, because the Board calculates variable costs for jurisdictional purposes, and maximum reasonable rates, using URCS costs. *See* WCTL Op. at 14-19.

In summary, if the BNSF acquisition premium is included in BNSF's 2010 URCS, the total variable costs will increase, as will the resulting jurisdictional threshold (variable costs x 1.80). For example, on a typical coal movement of 1,000 miles, the jurisdictional threshold will increase by \$0.58 per ton. *V.S. Crowley/Fapp Op. V.S. at Exh. 4, p. 1.* On a typical 1,200 mile grain movement, the jurisdictional threshold will increase by \$0.40 per ton. *Id. at Exh. 4, p. 2.*⁵ The increase in the jurisdictional threshold will mean fewer captive BNSF shippers will be able to invoke the Board's regulatory jurisdiction and many BNSF shippers will lose their right to seek redress at the Board if the Board includes the acquisition premium in BNSF's URCS. *Crowley/Fapp Op. V.S. at 10.*

As Coal Shippers/NARUC further demonstrated on Opening, in stand alone cost ("SAC") cases, both maximum rate metrics – the jurisdictional threshold and SAC,

⁵ If the impact of the Berkshire acquisition of BNSF on the URCS industry average cost of capital is considered, the actual per ton premium-generated increase for both movements is \$0.88 per ton. *See id. Exh. 4, pp. 1-2.*

are set using revenue-to-variable cost ("R/VC") ratios. Coal Shippers/NARUC Op. at 14-17. Thus, inclusion of the acquisition premium decreases the rate relief available to shippers litigating large rate cases against BNSF. For example, the maximum Maximum-Markup Methodology R/VC ratio on WFA/Basin Electric's prescribed rate (in STB Docket No. 42088) in 2011 is 246%. Crowley/Fapp estimate that payments under WFA/Basin Electric's rate prescription will increase by approximately \$1.9 million annually and by approximately \$25.2 million over the remaining life of the rate prescription, due to the inclusion of the acquisition premium in BNSF's URCS. Crowley/Fapp Op. V.S. at 20, Table 3.⁶

Last week, the Board issued a maximum rate decision in *Arizona Elec. Power Coop. v. BNSF Ry. & Union Pac. R.R. Co.*, STB Docket No. 42113 (STB served Nov. 22, 2011) ("*AEPCO*"). In *AEPCO*, the Board found that the allowable maximum reasonable rates under SAC were below 180 percent of the variable costs of service, and established new prescribed rates at the Board's jurisdictional threshold of 180% of the BNSF and Union Pacific Railroad's costs, through the year 2018. The STB has estimated that its decision provides an estimated \$63 million in reparations (back to 2009) and total rate reductions to complainant Arizona Electric Power Cooperative ("*AEPCO*"). While Coal Shippers/NARUC's cost experts have not yet had an opportunity to estimate the BNSF acquisition premium impacts on *AEPCO*'s rate prescription, should the premium

⁶ If acquisition premium-related cost of capital impacts are included, the impact on WFA/Basin Electric increases to \$31.5 million over the remaining life of the rate prescription. *Id.*

be allowed to be included in BNSF's URCS, there are clear and direct impacts on AEPCO's rates, just as there are clear and direct impacts on WFA/Basin Electric's rates, and these impacts will similarly be substantial (likely in the millions of dollars).

Premium-generated maximum rate increases also impact the results in Simplified SAC cases, as well as in small cases decided under the Board's Three Benchmark test. Inclusion of the acquisition premium in BNSF's URCS will decrease the amount of rate relief available to all shippers in all maximum rate cases brought before the Board – large, medium, and small. Coal Shippers/NARUC Op. at 21-24.

Finally, as Coal Shippers/NARUC described on Opening, inclusion of the acquisition premium has an impact on revenue adequacy. *Id.* at 17-19. For example, the Board recently found that the industry average cost of capital in 2010 equaled 11.03%.⁷ If BNSF's rate of return on its 2010 net investment is calculated without the addition of the acquisition premium, it equals 9.22%. Crowley/Fapp Op. V.S. at 24. If the acquisition premium is excluded, BNSF's rate of return on its 2010 net investment equals 10.05%. *Id.* Thus, inclusion of the acquisition premium moves BNSF further away from a Board determination that the carrier is "revenue adequate."⁸ BNSF does not dispute this fact, asserting merely that this metric is largely irrelevant for regulatory purposes as "BNSF has consistently fallen short of achieving revenue adequacy," but also admitting

⁷ See *Railroad Cost of Capital- 2010*, STB Ex Parte No. 558 (Sub-No. 14) (STB served Oct. 3, 2011) at 2.

⁸ Additionally, as Crowley/Fapp emphasized on Opening, the Board's exclusion of BNSF from the STB's cost of capital calculations for the railroad industry artificially increases the overall cost of capital for the railroad industry as a whole. *Id.* at 16-18.

that “the full effect of the Berkshire purchase accounting adjustment will not be reflected in the revenue adequacy calculations until 2012.” Baranowski/Fisher Op. V.S. at 6.

The Board’s revenue adequacy determinations play a central role in the application of the Board’s “revenue adequacy” constraint in large rate cases, which constraint calls for moderation of rail rates charged by revenue adequate carriers. *See Coal Rate Guidelines*. The Board’s revenue adequacy determinations also play an important role in setting maximum R/VC ratios in small rate cases using the Board’s Three Benchmark Methodology, with Three Benchmark R/VC ratios employing the Revenue Shortfall Allocation Method (“RSAM”) ratio which uses the STB’s revenue adequacy determinations as a metric in establishing maximum reasonable rates. Crowley/Fapp Op. V.S. at 23-24. Inclusion of the acquisition premium in the revenue adequacy calculation increases RSAM and the resulting maximum R/VC ratios set under the Three Benchmark Method. *Id.* at 24.

1. Both the Board and BNSF Have Stressed the Increased Importance of URCS Costs in a Range of Regulatory Proceedings

BNSF essentially asserts “no harm, no foul,” because it contends few cases are ever brought to the Board “out of hundreds of thousands” of BNSF rates, and it “will be rare that any shipper’s rates could be affected” by the BNSF premium pass-through. Hund Op. V.S. at 8-9. This is an astonishing assertion given the Board’s and BNSF’s past pronouncements that any changes in a railroad’s URCS costs do have significant impacts in critical regulatory proceedings as well as on a railroad’s financial bottom line.

And if it were really true that the \$8.1 billion BNSF URCS pass-through does not have any real regulatory or shipper impacts of any consequence, then BNSF should have no objections to excluding the premium from its rate base, and this should be reason enough for the Board to grant WCTL's Petition. However, BNSF's "no regulatory impacts" assertion is belied by the testimony of 21 shippers and shipper groups, NARUC, and USDA – along with 11 U.S. Senators who all believe that the premium will have real and substantial market and regulatory impacts on shippers. Not even the AAR makes a similar "no impact" contention in its Opening Comments.

a. The STB's Pronouncements on the Increased Importance and Use of URCS

In the past several years the Board has become increasingly reliant on URCS, and as stated, the Board has adopted several recent changes to its rate case methodologies that elevate the role of URCS in STB regulatory proceedings. As the Board has emphasized:

[T]he Board has increased its reliance on URCS. In the past 5 years, the Board has adopted a number of changes to its rate case methodologies that give URCS a more prominent role in determining whether a rate is reasonable and what relief a rail shipper should receive. The increased reliance on URCS costs should be accompanied by increased vigilance with regard to continued accuracy.

STB Report to Congress Regarding the Uniform Rail Costing System. Submitted Pursuant to Transportation and Housing and Urban Development and Related Agencies Appropriations Bill, S. Rep. No. 111-69 (2009) (dated May 27, 2010) ("STB URCS

Report”). In its URCS Report, the STB delineates the substantial impact and reach of URCS in the Board’s regulatory adjudications and proceedings:

URCS is used in a wide variety of Board proceedings. The most prominent use of URCS is in cases where a shipper has challenged the common carrier rate charged by a railroad as unreasonably high. The Interstate Commerce Act (ICA) provides that the Board has jurisdiction to entertain rate challenges only if the rail carrier has “market dominance” – i.e., where there is a lack of effective competition from other rail carriers or other modes of transportation – over the transportation at issue. The statute directs the Board to conclude that a carrier lacks market dominance (and therefore that the Board lacks jurisdiction) if the rail carrier proves that the revenue it derives from the challenged rate is less than 180% of its variable cost of providing the transportation (referred to as the revenue/variable cost ratio or R/VC). The Board uses URCS to determine what the variable costs of a movement are in order to make this threshold determination.

The Board also uses URCS at later stages of its railroad rate proceedings to determine whether the challenged rate is reasonable and, if necessary, to prescribe the maximum rate that can be charged. In rulemakings completed in 2006 and 2007, the Board increased its reliance on URCS across the spectrum of rate cases it adjudicates.

In the largest rate cases, which use the Board’s Stand-Alone Cost (SAC) methodology, URCS is used to allocate revenues and set reparations, if needed. The Board adopted its Average Total Cost (ATC) methodology that uses URCS variable costs to allocate revenues from cross over traffic. The Board also uses URCS variable costs in its Maximum Markup Methodology (MMM) to determine what reparations are due to the complainant when a rate is found to be unreasonable.

In medium-sized rate disputes, the Simplified SAC methodology uses URCS in the ATC and MMM methodologies as described above. In addition, Simplified

SAC uses URCS to develop the total operating expenses for the SARR.

Finally, in the smallest rate disputes, the Three Benchmark (3B) methodology compares the R/VC ratio of the challenged rate against the R/VC ratios for other comparable traffic on that railroad to determine whether or not the challenged rate is reasonable.

URCS is also used when a carrier seeks Board authorization to exit a market (i.e., “abandon” or “discontinue” service on a rail line). In such proceedings, the Board considers the “avoidable cost” of the line sought to be abandoned. Avoidable costs are the expenses that the rail carrier would not incur if it stopped providing transportation over the line. These avoidable costs are compared against actual and potential revenues to determine whether maintaining service over a line is economically feasible. The Board uses URCS to calculate the line’s avoidable cost.

The Board also uses URCS in proceedings where it must determine the compensation due to an incumbent railroad when the Board directs that another railroad may operate on the incumbent’s lines or whenever there is a regulatory need to value a rail line, such as for an offer of financial assistance for a rail line proposed to be abandoned.

Id. at 6-8 (footnotes omitted).

As Coal Shippers/NARUC set forth on Opening (*id.* at 39-40), when the Railroad Accounting Principles Board (“RAPB”) issued its Final Report nearly 25 years ago in 1987, the ICC *did not* rely directly on the use of variable costs in setting maximum rail rates on all rail traffic subject to its regulatory jurisdiction. *Railroad Accounting Principles, Final Report* (Sept. 1, 1987). Vol. 2 at 46 (“GAAP cost [is not] . . . used directly in ratemaking”). Nor were acquisition premiums a major concern in 1987 since

most carrier acquisitions at that time involved a write-down, not a write-up, in the acquired carrier's assets. Coal Shippers NARUC Op. at 40.⁹ Today, as explained above, URCS is a direct and critical component of ratemaking and is used in a multitude of regulatory proceedings. Because the "Board has increased its reliance on URCS," this "increased reliance on URCS costs should be accompanied by increased vigilance with regard to continued accuracy" – including removing the BNSF acquisition premium from BNSF's rate base in this instance.

b. BNSF's Pronouncements on the Increased Importance and Use of URCS

BNSF itself has repeatedly stressed the increased and central importance of URCS in the Board's regulatory proceedings:

- URCS variable costs are becoming an increasingly important element in the Board's rate reasonableness proceedings.
- With the Board's increasing reliance on URCS costs for regulatory purposes, it is important that the Board ensure that the URCS cost assumptions are accurate and up to date.

Testimony of Richard E. Weicher, BNSF Railway Company, STB Ex Parte No. 431

(Sub-No. 3), *Review of the Surface Transportation Board's General Costing System*

(URCS), (filed Apr. 23, 2009) at 1 ("STB URCS Proceeding"); *see also id.*, PowerPoint

⁹ *See Ass'n of Am. R.R.s v. ICC*, 978 F.2d 737, 740 (D.C. Cir. 1992) ("Because economic conditions in the railroad industry affect the value of rail assets, a net investment base calculated by acquisition costs will often be smaller than one calculated using original cost.").

Hearing Presentation (filed Apr. 30, 2009) at 1 (“Congress underscored the importance of variable costs by establishing a threshold R/VC ratio to determine whether the STB has jurisdiction over specific rates,” that “in recent years, URCS variable costs have become an increasingly important element in the Board’s rate reasonableness proceedings,” and “[w]ith the increasing reliance on URCS, it is important that URCS cost assumptions are accurate and up to date.”); *id.*, Additional Comments of BNSF Railway Company on the Board’s Proposed Review of URCS (filed June 1, 2009) at 2-3 (BNSF stresses that “URCS has a central role in the agency’s regulatory scheme” and that “since the Board is increasingly relying on variable cost calculations in rate reasonableness cases, it is important that those calculations be as accurate and current as possible”).

As BNSF has summarized:

[The STB’s review of URCS] comes about because of the statutory mandate that you use a URCS system in calculating variable costs and you’re using them very extensively now in many regulatory arenas more than ever.

Whether it’s the simplified SAC cases, the three benchmark standard or your average total cost methodology in coal cases, it’s permeating everything.

Id., STB Hearing Transcript (dated Apr. 30, 2009), Statement of Richard E. Weicher at 122.

On Opening, BNSF attempts to challenge the impact of URCS changes in Three Benchmark cases, asserting that in such cases “the outcome often turns on the selection of the comparison group, which is a process that relates to factors that reflect demand and other characteristics of the shipments, rather than R/VC calculations.”

Baranowski/Fisher Op. V.S. at 9. However, BNSF has testified to the Board that *both* Three Benchmark and Simplified SAC cases “rely heavily on URCS costs and R/VC ratios.” *STB URCS Proceeding*, Additional Comments of BNSF Railway Company on the Board’s Proposed Review of URCS (filed June 1, 2009) at 3. As BNSF clarified in the *STB URCS Proceeding*, URCS costs matter in Three Benchmark cases because: “[t]he new Three Benchmark test for small rate cases establishes maximum reasonable rates by comparing the R/VC ratio of the issue traffic to the average R/VC ratio of a comparison group, adjusted to account for revenues needed by the defendant to become revenue adequate.” *Id.*

BNSF’s recent pronouncements to the Board confirm that URCS is used “very extensively now in many regulatory arenas more than ever.” getting BNSF’s URCS right in this instance is critical as “URCS [plays a] central role in the agency’s regulatory scheme,” and that in maximum rate cases, URCS is “permeating everything.”

2. The Impact of the BNSF Acquisition Premium is Substantial

Despite BNSF’s protestations in this proceeding that the premium-infused impacts will result in only “modest” impacts on URCS costs, and a small subset of traffic, that is certainly not the case. As referenced above, Crowley/Fapp estimate that payments under WFA/Basin Electric’s rate prescription will increase by approximately \$1.9 million annually and by approximately \$25.2 million over the remaining life of the rate prescription, due to the inclusion of the acquisition premium in BNSF’s URCS. Crowley/Fapp Op. V.S. at 20. Table 3. The impacts will be similar in all large rate cases.

including the recent *AEP*CO rate case shipper victory, because, as BNSF has confirmed, the amount of revenue at issue in such cases is “very large”:

The amount of revenue that is at stake in coal rate cases is very large. In the 1996 West Texas Utilities decision, the Board ordered BNSF to reduce its rates by 31 percent. WTU’s successor, AEP Texas, has returned to the Board asking for further rate reductions. In the 1998 Arizona Public Service decision, the Board ordered a 44 percent rate reduction. BNSF has estimated that the Arizona Public Service rate prescription cost BNSF between \$55 and \$60 million by the time the rate prescription was removed late last year. Last month BNSF was ordered to pay reparations to Xcel Energy of over \$11 million. Otter Tail, AEP Texas and Basin Electric are asking for substantial additional reparations in their cases in the tens of millions of dollars.

Statement of John P. Lanigan, STB Ex Parte No. 657, *Rail Rate Challenges Under the Stand-Alone Cost Methodology* (Public Hearing Testimony filed Apr. 20, 2005) at 3.¹⁰

Even in smaller Three Benchmark and Simplified SAC cases, the amount of dollars at stake can be in the millions.

¹⁰ BNSF asserts that the BNSF acquisition premium impacts here are similar to those found in *Conrail*, where the acquisition premium involved carrier variable cost increases ranging from 4.9% to 7.26%. BNSF Op. at 20. BNSF neglects to inform the Board, however, that *Conrail* involved projected per year merger synergies of \$1 billion, with a much smaller acquisition premium of \$3.7 billion, which allowed the premium to be recovered in only 3.7 years. See Coal Shippers/NARUC Op. at 34. Additionally, the Board carefully reviewed and found in *Conrail* that these merger synergies, other efficiencies, and then-existing railroad productivity growth (at levels that are no longer present today) would collectively push *down* the level of rates. *CSX Corp. – Control & Operating Leases/Agreements – Conrail Inc.*, 3 S.T.B. 196, 263-64 (1998). No attempted similar showing of offsetting synergies or rate decreases has been made by BNSF here because, as BNSF has made clear, there are no synergies involved with Berkshire’s acquisition of BNSF and rates will not decrease as a result of the transaction. See Coal Shippers/ NARUC Op. at 24-27.

In fact, in recent Board proceedings, BNSF has vigorously pursued Board action and assistance to allow it to “determine and allocate all of [its] costs in URCS” and that the Board “must acknowledge and allow BNSF to fully recover [its] costs” in the context of the transportation of hazardous materials. Comments of BNSF Railway Co., STB Ex Parte No. 681, *Class I Railroad Accounting and Financial Reporting Transportation of Hazardous Materials* (filed Feb. 4, 2009).

While significant, the level of costs involved to date with the transportation of hazardous materials that individual railroads are seeking to recover through URCS do not come even close to the \$8.1 billion costs that BNSF is seeking to recover as part of its premium pass-through. *See, e.g.*, Letter from Union Pacific Railroad Co. to STB, STB Ex Part No. 706, *Reporting Requirements for Positive Train Control Expenses and Investments*, at 1 (UP seeks to separately identify and include in its annual R-1 to be included in UP’s URCS a total of \$250 million in 2011 expenses related to Positive Train Control, which UP asserts is necessary for the Board to be able to “pursu[e] its oversight responsibilities and regulatory initiatives”); Reply Comments of Norfolk Southern Ry. Co., STB Ex Parte No. 706, *Petition of Union Pacific Railroad Co. to Institute A Rulemaking Proceeding to Adopt Reporting Requirements for Positive Train Control*, at 4-5 (NS reports that it has spent “over \$60 million since the inception of its PTC program in 2005 – on PTC implementation” that it asserts “must be reasonably compensated for . . . through the rate regulatory regime”). In these other proceedings, BNSF and other

railroads have asserted that the addition to URCS of even relatively small amounts of costs matter.

Additionally, as set forth above, if the Board includes the acquisition premium in BNSF's URCS, the increase in the jurisdictional threshold will mean fewer captive BNSF shippers will be able to invoke the Board's regulatory jurisdiction and seek redress at the Board. BNSF on Opening tries to dismiss this impact stating that less than 2 percent of BNSF shippers fit in this category. BNSF Baranowski/Fisher Op. V.S. at 5-6. However, as Coal Shippers/NARUC demonstrated on Opening, the number of shippers impacted is real and substantial. Crowley/Fapp estimate that many BNSF shippers will lose their right to seek redress at the Board if the Board includes the acquisition premium in BNSF's URCS. Crowley/Fapp Op. V.S. at 10.

Also, a crucial element of Rail Transportation Policy is "to maintain reasonable rates where there is an absence of effective competition" (49 U.S.C. § 10101(6)) and under the law, rates on market dominant traffic "must be reasonable." *Id.* at § 10701(d)(1). The law does *not* state that rates on market dominant traffic "must be reasonable, but only when a shipper has a rate significantly above 180% of variable costs." In any event, while many shippers agree (as does the U.S. Government Accountability Office in several prominent studies) that there are too many barriers to accessing the Board's regulatory rate relief remedies, surely the answer is not to create new barriers to regulatory access by allowing BNSF's acquisition premium to be included in the rate base.

Further, rate cases involving BNSF have often been prescribed at or very near the jurisdictional floor. *See, e.g., AEPCO*; Statement of BNSF regulatory counsel Samuel M. Sipe, Jr., STB Ex Parte No. 657, *Rail Rate Challenges Under the Stand-Alone Cost Methodology* (Public Hearing Testimony filed Apr. 20, 2005) at 2 (“In two SAC decisions in the 1990s, the Board prescribed rates for BNSF at the jurisdictional floor. In two recent SAC decisions involving BNSF, the Board has prescribed rates that exceed the jurisdictional floor by relatively small amounts.”).¹¹

Moreover, the AAR has recently highlighted the Board’s Commodity Revenue Stratification Reports (“Stratification Reports”) to show the enormous amount of railroad traffic and revenues subject to potential rate complaints (traffic with R/VC ratios greater than or equal to 180%). *See* STB Commodity Revenue Stratification Report for 2008 (located at <http://www.stb.dot.gov/econdata.nsf/09a17a28a74b350d852573ae006d52cd/c50c709cc6f1d6ac852577740051076f?OpenDocument>). The STB’s most recent Stratification Report shows that the total revenues at stake for traffic moving above 180% of variable costs amounts to \$21 billion in 2008 – amounting to over one-third of all revenues received by the railroads during the year. *Id.* As the AAR has confirmed, for coal and chemical commodities, the two major commodities involved in

¹¹ Additionally, in several recent cases, the parties have stipulated and agreed to prescribed rates to be established at 180% R/VC ratios. *See Oklahoma Gas & Elec. v. Union Pac. R.R.*; STB Docket No. 42111 (STB served July 24, 2009); *KCP&N v. Union Pac. R.R.*, STB Docket No. 42092 (STB served May 19, 2008). In each case, the Board found that the defendant carrier’s common carrier rates exceeded 180% of its variable costs and prescribed maximum reasonable rates equal to 180% of costs.

the vast majority of rate cases, the percentage share of traffic with R/VC ratios at or above 180% is 46% for coal traffic and 52% for chemical traffic. *See id.: accord* Initial Comments of the AAR, STB Docket No. Ex Parte No. 705, *Competition in the Railroad Industry*, William J. Rennie V.S. at 9 (filed Apr. 11, 2011).

According to the AAR, overall, “34 percent of rail shipments . . . are defined as ‘potentially captive’ because they generate revenues above 180 percent of variable costs.” *Id.* While the Board does not publish a similar commodity Stratification Report by rail carrier, it is clear that BNSF, as the nation’s largest rail carrier, has a very large amount of traffic subject to potential rate regulation (with R/VC ratios at or above 180%). It is simply not true that that impacts of passing through the BNSF acquisition premium on affected shippers is very small or that the impact of BNSF’s acquisition premium potentially affects only a very small portion of BNSF’s traffic.

3. The Use and Threat of Rate Cases is Not Isolated, and BNSF Has Been Involved in a Disproportionate Amount of Cases Where URCS Costs Matter

Contrary to BNSF’s assertion on Opening that the \$8.1 billion acquisition premium does not matter because very few rate cases are brought, BNSF’s legal officers have unequivocally asserted that rate cases are not isolated events, but instead, are “available,” “real,” and “full[y]” utilized, both in ratemaking and in commercial negotiations:

It has been BNSF’s experience that shippers have made full and effective use of [their right to bring a rate case] in formal rate reasonableness cases and informal proceedings before the

Board, as well as in bilateral commercial negotiations with the railroad. . . .

While BNSF might not always agree with the outcome of individual STB proceedings, the mechanisms for addressing alleged market abuses are available and real.

Initial Comments of BNSF Railway Co., STB Ex Parte No. 705, *Competition in the Railroad Industry*, (filed Apr. 12, 2011) (filed by Roger P. Nober, Esq., Richard E. Weicher, Esq., and Jill K. Mulligan, Esq.); Statement of BNSF regulatory counsel Samuel M. Sipe, Jr., STB Ex Parte No. 657, *Rail Rate Challenges Under the Stand-Alone Cost Methodology* (Public Hearing Testimony filed Apr. 20, 2005) at 2 (there has been a “recent surge of rate litigation”).

Additionally, BNSF is the King of rate cases. No railroad has been involved as a defendant in more SAC cases at the Board than BNSF in recent years.¹² BNSF is also a defendant in a recently filed Three-Benchmark case.¹³

¹² See, e.g., *AEPCO, Western Fuels Ass'n, Inc. & Basin Elec. Power Coop., Inc. v. BNSF Ry.*, STB Docket No. 42088 (STB served Feb. 18, 2009); *AEP Tex. N. Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No. 1) (STB served Sept. 10, 2007); *Otter Tail Power Co. v. BNSF Ry.*, STB Docket No. 42071 (STB served Jan. 27, 2006); *Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & S.F. Ry.*, STB Docket No. 42057 (STB served June 8, 2004); *PPL Montana, LLC v. BNSF Ry.*, 6 S.T.B. 752 (2003); *Texas Mun. Power Agency v. BNSF Ry.*, 6 S.T.B. 573 (2003); *Ariz. Pub. Serv. Co. and Pacificorp v. Atchison, T. and S.F. Ry.*, 2 S.T.B. 367 (1997); *W. Tex. Utils. Co. v. Burlington N. R.R.*, 1 S.T.B. 638 (1996).

¹³ STB Docket No. 42132, *Canexus Chems. Canada L.P. v. BNSF Ry.* (filed Nov. 14, 2011).

II.
BNSF'S OTHER ARGUMENTS HAVE BEEN FULLY ADDRESSED BY COAL SHIPPERS/NARUC ON OPENING

The remaining points BNSF attempts to make in defense of its attempted premium pass-through are points that are fully addressed by Coal Shippers/NARUC in their Opening Evidence, and there is no need to repeat that presentation here. However, because BNSF engages in several mischaracterizations of the legal standards involved, the type of relief WCTL is requesting, and how the law should be applied in this case, Coal Shippers/NARUC provide the following additional argument.

A. WCTL's Petition Does Not Ask the Board to Set New Rules or Apply a Different Standard in This Proceeding

BNSF repeatedly asserts that its attempted acquisition premium pass-through is permitted in this instance because this issue “has long been settled,” that “proponents of an exception . . . bear a heavy burden,” and that WCTL is attempting to “apply[] a different standard to Berkshire’s acquisition of BNSF” or otherwise “carve out an exception to the use of acquisition cost for URCS costing or revenue adequacy calculations.” BNSF Op. at 2, 5, 11. BNSF also asserts that “[i]t is unclear from WCTL’s petition whether it seeks to amend the USOA as applied to all mergers and acquisitions or to restrict its request for relief to Berkshire’s acquisition of BNSF.” *Id.* at 10.

WCTL’s Petition is not asking the Board to implement a new rule on acquisition premiums applicable to all future mergers or acquisitions. Instead, it is seeking to have the Board apply existing law, based on the facts of the Berkshire

transaction, and resolve the dispute between WCTL and BNSF by (i) removing the acquisition premium from BNSF's URCS costs, starting with BNSF's 2010 URCS, and (ii) by removing the premium from BNSF's rate base for revenue adequacy purposes, starting with the Board's 2010 annual revenue adequacy determination. This remedy is a simple, straightforward, mechanical exercise. *See* Coal Shippers/NARUC Op. at 41-46.

1. Precedent Supports WCTL's Petition and GAAP Accounting Principles Do Not Govern Regulatory Ratemaking

Coal Shippers/NARUC thoroughly addressed on Opening the fact that prior Board merger decisions support the removal of the premium from BNSF's URCS in this instance, and that precedent does not hold that acquisition premiums *must* be included in the acquired carrier's variable costs. *See id.* at 33-36. As demonstrated therein, each of the cases BNSF cites involved a merger of two or more railroads: was subject to prior Board approval; and in approving these mergers, the Board found that merger synergies would generate rate reductions for the merged carriers' customers.

Berkshire's acquisition of BNSF differs significantly from prior rail mergers the Board has considered. Unlike those prior mergers, Berkshire's acquisition of BNSF was not one approved by the Board, involves a far larger premium than those involved in prior mergers, and involves no synergies that can offset acquisition premiums. Also, granting the requested relief is consistent with basic notions of regulatory fairness, basic principles of rate regulation employed by all other federal and state regulators, and does not single BNSF out for disparate treatment. Coal Shippers/NARUC Op. at 24-33.

Additionally, Coal Shippers/NARUC demonstrated on Opening that, despite BNSF's repeated assertions to the contrary, GAAP accounting does not govern regulatory ratemaking. *Id.* at 36-41; *see Farmers Union*, 584 F.2d at 418. To be clear, no one is challenging BNSF's 2010 financial reporting under GAAP and even BNSF admits that this is not the issue to be decided here in this proceeding. *See* Letter from Robert M. Jenkins III to Peter A. Pfohl (dated Oct. 17, 2011) at 1 ("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."). Instead, as Coal Shippers/NARUC have emphasized, this case is not governed by GAAP or any other accounting principles, because ratemaking principles, not GAAP or other accounting principles, governs here. Coal Shippers/NARUC Op. at 36-41.

B. BNSF's Unwarranted Attempts to Pigeonhole the Petition as Raising a Simple "Circularity" Question

BNSF spends a significant part of its Opening Evidence in creating a straw man. It contends that WCTL is arguing that denial of recovery of the BNSF premium is warranted here because "circularity" problems exist, with an acquirer paying artificially inflated prices for assets in hopes of recovering inflated returns from ratepayers. BNSF Op. at 19. BNSF then asserts that Board precedent has clearly rejected this argument in the context of railroads. *Id.*

To be clear, neither WCTL nor Coal Shippers/NARUC is arguing that such a total circularity problem exists here. As stated on Opening, Coal Shippers/ NARUC congratulate Mr. Buffett on making a good deal for himself and other Berkshire

shareholders. Coal Shippers/NARUC are not contending that the transaction price was not *bona fide*, or that Mr. Buffet is attempting to “game” the system by paying an inflated price for BNSF in the hopes of recovering inflated returns from all of BNSF’s customers. This proceeding is not about Mr. Buffet’s intent or about any attempt to game the system.

Instead, Coal Shippers/NARUC simply ask that the good fortune for the new owners of BNSF does not directly translate into misfortune for captive BNSF customers in the form of rates that are increased solely because the ownership of BNSF changed hands. Additionally, as Coal Shippers/NARUC stated on Opening, no public utility regulator would allow the inclusion of the Berkshire premium in a regulated rate base on the facts of this case – not because of total circularity *per se*, but rather, because of notions of fundamental fairness, and the need to protect the ratepayer and the regulatory framework. Coal Shippers/NARUC Op. at 24-33. Any such inclusion is fundamentally unfair because it requires captive BNSF customers to pay higher rates for the same service, forces them to pay twice for the same assets, and offers absolutely no offsetting benefits. *Id.* The Board should follow suit here, and deny the BNSF acquisition premium pass-through.

CONCLUSION

For the reasons set forth above, and in their Opening Evidence, Coal Shippers/NARUC respectfully request that the Board issue a declaratory order excluding the acquisition premium from BNSF’s URCS, starting in 2010, and excluding the

premium in calculating BNSF's net investment base for revenue adequacy purposes,
starting in the Board's 2010 revenue adequacy determination.

Respectfully submitted,

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EDISON ELECTRIC INSTITUTE
NATIONAL ASSOCIATION OF REGULATORY
UTILITY COMMISSIONERS
NATIONAL RURAL ELECTRIC
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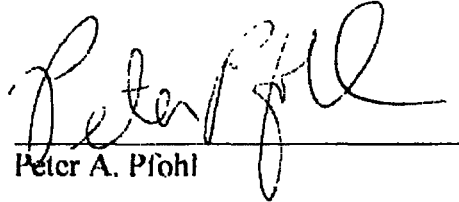
(202) 347-7170

Dated: November 28, 2011

Their Attorneys

CERTIFICATE OF SERVICE

I hereby certify that this 28th day of November, 2011, I have caused copies of the forgoing to be served via first-class mail, postage prepaid upon all parties of record to this case.


Peter A. Pfohl