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May 11, 2021

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VIA E-FILING

Cynthia T. Brown
Chief of the Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington DC 20423-0001

ENTERED
Office of Proceedings
May 11, 2021
Part of
Public Record

Re: BNSF Railway Company – Terminal Trackage Rights – The Kansas City Southern
Railway Company And Union Pacific Railroad Company,
FD 32760 (Sub-No. 46)

Dear Ms. Brown:

In response to the Surface Transportation Board's Decision Nos. 8 and 9, The Kansas City Southern Railway Company ("KCS") hereby files, via e-filing, KCS's Rebuttal Brief on Compensation. KCS's Rebuttal Brief is being filed in both a "Public Version" and a "Highly Confidential" version. Please note only the Julie M. Carey Rebuttal Verified Statement contains highly confidential information and that information is redacted in the public version. If there are any questions concerning this e-filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller.com. If I am unavailable, you may contact my associate, Crystal M. Zorbaugh, by telephone at (202) 663-7831 or by e-mail at czorbaugh@bakerandmiller.com.

Sincerely,

/s/ William A. Mullins

William A. Mullins

Enclosures

cc: Parties of Record

PUBLIC VERSION

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FD 32760 (SUB-NO. 46)

**BNSF RAILWAY COMPANY
-- TERMINAL TRACKAGE RIGHTS APPLICATION --
THE KANSAS CITY SOUTHERN RAILWAY COMPANY AND
UNION PACIFIC RAILROAD COMPANY**

KCS'S REBUTTAL BRIEF ON COMPENSATION

PREFACE

The only issue before the STB is setting compensation for BNSF terminal trackage rights to Lyondell¹ based on principles applicable in condemnation proceedings.² BNSF's compensation proposal does not satisfy principles applicable in condemnation. Accordingly, the STB should reject BNSF's proposal and adopt KCS's market-based proposal, which seeks to ensure that BNSF pays compensation for access to Lyondell based on condemnation principles, as mandated by 49 U.S.C. § 11102(a).

¹ BNSF requested the STB to set terms and conditions for access to Lyondell. BNSF-132 at 1. The STB established terms for BNSF access to Lyondell and said it would establish compensation for access to Lyondell. "[P]ursuant to 49 U.S.C. § 11102(a), the STB establishes conditions for BNSF's use of the Rosebluff Lead ["Lead"] to directly serve the Lyondell facility and sets forth a procedure for setting compensation." Decision No. 8 at 1. KCS reiterates its objections to BNSF's December 18, 2020 Petition for a "quasi-exemption-like" process to apply findings of Decision No. 8 and the STB's impending decision to other customers on the Lead, particularly under a cost-based SSW Compensation ["SSW"] approach. As the STB stated in Decision No. 8, SSW is determined by "case-specific facts concerning the market value of the property, the tenant's proportionate use, and the costs associated with such use." *Id.*, at 16. Because the proceeding at this stage is directed only for service to Lyondell, the STB cannot, and should not, use findings here to be also applicable and transferrable to BNSF's December 18 request for blanket findings, which do not apply "case-specific facts."

² 49 U.S.C. § 11102(a).

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I. The “Prescribed Fee” Does Not Meet The Standards Of 49 U.S.C. § 11102(a)

A. The Statute Requires Application of Condemnation Principles

Despite the passage of over 20 years following the UP/SP merger, BNSF never followed the STB’s direction in that proceeding to negotiate or arbitrate with UP and KCS for access in the Lake Charles area.³ Instead, BNSF applied for terminal trackage rights under Section 11102. Section 11102(a) requires the STB to “establish conditions and compensation for use of the facilities under the principle controlling compensation in condemnation proceedings.” BNSF’s application makes that the standard governing the STB’s next decision in this proceeding.

The parties and the STB have all acknowledged that as an owner of the Lead, KCS is entitled to compensation under § 11102(a). Decision No. 8 at 15. All of BNSF’s various unsupported and self-serving arguments (see Section II) to minimize compensation due for use of the Lead commit the same fatal flaw: BNSF’s compensation proposal does not satisfy the requirements of Section 11102(a).

Under Section 11102(a), the STB’s focus must be on what the track owner has lost, not what the taker has gained. See Mo.-K.T.R. Co. v. Kan. City Terminal Ry., 198 I.C.C. 4, 7-8 (1933).⁴ Put another way, condemnation principles require that BNSF pay what the owners of the facility lose by virtue of BNSF’s access – i.e., the market value of the access.

³ F.D. 32760, Dec. No. 63, 1996 WL 691928 at *5 (“As to the terms of the four KCS-T & NO joint facility agreements, if the parties (KCS, BNSF, and UP/SP) are not able to come to an agreement, any differences in interpretation of the four joint facility agreements may be submitted to arbitration under the terms of those agreements. If the parties (KCS, BNSF, and UP/SP) are unable to agree and the arbitral interpretation produces a situation where BNSF access to the Lake Charles area is blocked, BNSF may return to seek approval of a terminal trackage rights application under new 49 U.S.C. 11102(a)...” [footnotes omitted])

⁴ See also U.S. v. General Motors, 323 U.S. 373, 379 (1944) (“U.S. v. GM”) (“In the light of these principles it has been held that the compensation to be paid is the value of the interest taken. Only in the sense that he is to receive such value is it true that the owner must be put in as

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BNSF's so-called "Prescribed Fee" does not compensate the owners of the Lead for what BNSF direct access to Lyondell would take from the owners. The "Prescribed Fee" was a deal made between UP and BNSF, not KCS, for an exchange of trackage rights.⁵ The STB has found that the fee is "lower than what we would impose under SSW."⁶ So, even if SSW met the standards of Section 11102(a) – which it does not – the Prescribed Fee is not SSW. That BNSF and UP may have worked out compensation for other rights, without KCS's involvement, is irrelevant to the compensation the STB must establish pursuant to 49 U.S.C. § 11102(a).

Section 11102(a) requires compensation to be set based on the value of the property taken. The value of a business property is its ability to generate revenue. See U.S. v. GM, 323 U.S. at 378 ("property" is "[T]he group of rights inhering in the citizen's relation to the physical thing, as the right to possess, **use** and dispose of it."), making the market-based rate proposed by KCS the sole appropriate measure of compensation BNSF should pay for use of the Lead.

Determining fair compensation does "not start from a blank slate," and, any compensation established must be consistent with the intent of Congress.⁷ The STB starts with the requirements of the governing statute. Where no ambiguity exists in a statute, there is no room for construction. Pub. Serv. Comm'n of Or. v. Cent. Pac. Ry. Co., 159 I.C.C. 630, 634-635 (1929).

good position pecuniarily as if his property had not been taken. In the ordinary case, for want of a better standard, market value, so-called, is the criterion of that value.")

⁵ BNSF admitted in its opening statement, the "Prescribed Fee" referred to by BNSF ... is the Merger Fee set by Section 9(a), as escalated by Section 12, of the Restated & Amended BNSF Agreement, and as modified by BNSF and UP in Section 7 of the 50/50 Line Agreement (as amended by Sections 1 and 4 of the 2003 Letter Agreement). See BNSF Suppl. 6, Feb. 4, 2019 (BNSF-139). See BNSF-144 at 6.

⁶ UP/SP Decision No. 47, 1996 WL 512020 at *15.

⁷ Pyco Indus., Inc. – Alt. Rail Serv. – S. Plains Switching Ltd. Co.; S. Plains Switching, Ltd. Co. – Comp. for Use of Facilities In Alt. Rail Serv. – W. Tex. and Lubbock Ry. Co., FD 34889, 34802, FD 35111, slip op. at 6 (S.T.B. served Jan. 11, 2008).

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B. BNSF's Compensation Proposal Is Not Consistent With Condemnation Principles

In this case, neither the Prescribed Fee nor SSW satisfies the “principle controlling compensation in condemnation” requirement. Even if SSW did, which it does not, BNSF is not even asking the STB to apply traditional RCNLD-based SSW.

The STB expressed its construction of 49 U.S.C. § 11102(a) in Decisions No. 6 and 8 by making clear that (1) KCS must have a role in establishing compensation and (2) that where parties disagree the STB “may establish . . . compensation for such use under the principle controlling compensation in condemnation proceedings.” To be consistent with the principle controlling compensation in condemnation proceedings required by Section 11102(a), BNSF must fully compensate the owners of the Lead for what they have lost due to BNSF trackage rights access. BNSF’s proposal does not meet that standard.

As explained by Ms. Marzulla, fair market value is the Constitutional standard used in condemnation proceedings,⁸ and as explained by Prof. Carey, e.g., KCS Reply at 150-159, neither CE-based nor RCNLD-based SSW approximate the fair market value of the business opportunity taken from the Lead’s owners by BNSF trackage rights. SSW – regardless of whether CE Approach-Based or RCNLD-Based - is incapable of putting KCS in the same place it would have been but for BNSF’s access; thus, it is incapable of compensating KCS as required by Section 11102.⁹ For the owners of the Lead to receive the full value taken by BNSF trackage rights, the

⁸ Marzulla Rebuttal VS (“NMVS”), section 3.

⁹ For 24 years, BNSF’s below-market access fee has given BNSF an undue competitive advantage over KCS, an advantage which BNSF seeks to expand through this proceeding. This access has artificially suppressed the earnings that KCS otherwise would have achieved, which, in turn, produces a lower value than what otherwise should apply in a CE approach, making SSW inconsistent with the condemnation principles and failing to fully compensate KCS for BNSF’s access. SSW was intended to apply to overhead trackage rights or voluntary agreements and has never been used to set compensation that included access to local shippers. In FN 24 to

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owners must receive a comparable market-based rate. But BNSF does not even offer RCNLD-based SSW. Instead, BNSF offers various arguments that compensation due to KCS should be set below SSW.

The STB should reject BNSF's attempts to minimize the compensation it pays, which seeks merely to continue UP and KCS subsidizing BNSF's operations into perpetuity. BNSF has not proven that it will not be able to compete if it were required to pay compensation based on condemnation principles¹⁰ or established that any of its proposals are valid legally, economically, or financially. Even if BNSF had shown that its ability to compete would be impaired by paying fair market value for access, the STB is bound by Section 11102(a) - the statute under which BNSF applied - to require BNSF to pay the fair market value of what is taken.

As demonstrated in the KCS Reply, requiring BNSF to pay market-based compensation will not harm BNSF's competitive position. KCS Reply at 12. On the other hand, applying just the "Prescribed Fee" or even SSW would simply continue to provide BNSF with a competitive advantage, contrary to the statute. Only a market-based fee meets the statutory requirement. Application of the BNSF proposal simply continues BNSF's unfair competitive advantage.¹¹

Decision No. 8, the STB states that the STB has previously found that SSW satisfies the principles of compensation in condemnation cases. That statement has never been judicially affirmed. Moreover, SSW was not applied in all of the cases cited in FN 24, including the case that set compensation that included access to local shippers. Perhaps most important, none of the circumstances in those cases were akin to the situation at Lake Charles. Accordingly, the STB cannot affirm that SSW, as applied to access to local shippers, is consistent with condemnation principles.

¹⁰ From an economic point of view in which the free market is the determiner of pricing, Market-based Direct Access should cost more than reciprocal switch access, because if two railroads were negotiating trackage rights compensation that included access to shipper facilities, such expanded access would cost more than simple overhead trackage rights. This is because the rights the tenant was seeking to acquire had increased value in the form of an established customer base.

¹¹ UP's grant of switching access to BNSF as the means to fulfill the Lake Charles condition has more than fulfilled the purpose of that condition and is the least intrusive remedy by which to

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BNSF’s argument that it has already taken the fair market value of the Lead through reciprocal switch access and therefore need not compensate the owners of the Lead for access via trackage rights also contradicts condemnation principles. BNSF admits in the BNSF Reply that “BNSF has had “commercial” access to these shippers for the last quarter-century, with the ability to both provide single-line service with traffic remaining in the account of BNSF, and to set prices independently.” BNSF Reply at 12. But that commercial access has been at the cost-based rate that UP and KCS agreed to nearly two decades ago. It is not a market-based rate. Furthermore, KCS has never been compensated for BNSF’s commercial presence on the Lead.

For BNSF to insist that it does not need to pay for access going forward because whatever harm KCS suffered would “presumably continue regardless of whether BNSF institutes direct service using its terminal trackage rights”, *id.* at 14, is simply to say that BNSF does not have to pay what the statute requires. Section 11102(a) mandates that BNSF compensate KCS for what KCS, as the owner of an undivided interest in the Lead, loses by virtue of BNSF’s access on the Lead— *i.e.*, the market value of the access. Contrary to BNSF’s claims, KCS is not seeking to recover 25 years of lost profits, but rather to be compensated based on principles of condemnation (*i.e.*, a market-based rate) for the access BNSF seeks going forward.

Despite acknowledging that “any loss suffered by KCS” resulted in 1996 as a result of Decision Nos. 44 and 63 (which gave BNSF access to the Lead), BNSF nevertheless attempts to

resolve the competitive problems from the merger. Indeed, for nearly 18 years, BNSF’s market share of traffic in the region grew steadily, even before BNSF expanded SIT capacity. As a result, BNSF has a substantial market share of traffic. KCS August 24, 2015 Reply at 77-93. FN 22 in KCS’s Reply (April 12, 2021) explains that fierce competition continues to be present on the Lead for Lyondell and other shippers. BNSF and UP vied for Lyondell’s business and despite UP having higher costs due to its maintenance obligation, UP was victorious. Adopting BNSF’s compensation proposal simply seeks to give BNSF a greater unfair competitive advantage, without it carrying the same maintenance and operating obligations as UP and KCS.

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argue that no taking has occurred or will occur in the future. In doing so, BNSF makes several unsustainable attacks on KCS's application of takings law. As explained in Nancie Marzulla's NMVS, BNSF's position refuses to acknowledge that just compensation is the bedrock principle applied in condemnation proceedings, and thus, according to the statute, is the rule that governs compensation in this proceeding. See NMVS at 1.

Likewise, there is no constitutional support for BNSF's argument that KCS's right to just compensation in a condemnation proceeding—and thus KCS's right to just compensation here—disappears simply because KCS jointly owns an undivided interest in the Lead. Id. at 2. BNSF is simply wrong in contending that just compensation is not warranted going forward because the damages would “presumably continue regardless of whether BNSF institutes direct service using its terminal trackage rights.” Id. at 14. BNSF's position, which ignores the standard applied in thousands of condemnation proceedings, would give KCS no compensation, which is completely contrary to the statute and the STB's own previous decision noting that KCS is entitled to compensation.

Just compensation, which is the standard applicable to condemnation principles, is customarily defined as fair market value. Id. See also U.S. v. GM, (“[T]he compensation to be paid is the value of the interest taken. Only in the sense that he is to receive such value is it true that the owner must be put in as good a position pecuniarily as if his property had not been taken. In the ordinary case, for want of a better standard, market value, so-called is the criterion of that value.”) The only evidence in the record capable of making KCS whole by paying KCS fair market value for the access BNSF seeks is the market-based rate proposed by KCS's witness, Prof. Carey.

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BNSF claims without any support that many of Prof. Carey's arguments are flawed. As Prof. Carey explains in her rebuttal verified statement ("JCVS"), Mr. Baranowski's ("FTI's") attacks are meritless. The JCVS refutes FTI's various criticisms and explains, for example, why BNSF's argument is wrong that the fact that KCS contributions are flat shows the absence of KCS revenue suppression. JCVS at 1.¹² Prof. Carey also explains why neither David Reishus ("Reishus") nor FTI's market analysis is correct.

None of FTI's criticisms of Prof. Carey's market-based rate are supported or have merit. Prof. Carey explains in seven points why FTI's attacks and analysis are flawed. See JCVS at 4-6. Prof. Carey refutes FTI's claim that she biased rates upward without justification, that reciprocal switch rates are only cost-based and have no market-based component, that Prof. Carey's presentation of geographical considerations in her reciprocal switch rate study is flawed, and that since average switch rates for BNSF, UP and KCS approximate the URCS fully allocated (FAC) costs, there is no market-based contribution and therefore the RSAM based rate should be rejected. Id. Likewise, Prof. Carey shows that FTI's woefully inadequate suggested alternative to using a SAC first-year capital recovery using replacement cost new is flawed for the same reason FTI's RCNLD analysis is flawed.

Likewise, BNSF's other witness Reishus's attacks on Prof. Carey's evidence fails to recognize that SSW rates (based on RCNLD or CE) are inadequate and are dramatically understated due to BNSF's presence on the Lead for 25 years. Reishus offers no evidence to support his claim that the "market value" requested by KCS is far more than the incremental value of the trackage rights, that a presumption of arms-length switching rates is inappropriate,

¹² Another flawed argument offered by FTI is that, in BNSF's opinion, KCS is doing well enough financially, and as a result, the STB should ignore revenue adequacy implications.

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or that Prof. Carey culled data to engineer a value higher than what the data yields. In short, none of BNSF's criticisms refute the fact that condemnation principles require that BNSF pay what the owners of the facility lose by virtue of BNSF's access – i.e., the market value of the access.

C. Although The Statute Requires Imposition Of A Market Based Rate, If The STB Ignores That Standard And Applies SSW, It Should Adopt Dr. Neels' Approach

Prof. Carey's market-based compensation is the only evidence in the record that satisfies the requirement of Section 11102(a). However, given that Decision No. 8 barely stopped short of stating the STB would establish compensation based on SSW, KCS felt compelled to submit SSW evidence, even though KCS does not believe SSW should be applied or that it satisfies condemnation principles. Regardless of whether based on RCNLD or CE, SSW will not compensate KCS as required by the statute. Of course, KCS believes that the CE-Based SSW compensation proposed by Dr. Kevin Neels ("KN") is the more reliable of the two SSW compensation proposals in the record. As such, KCS is also including a rebuttal verified statement from Dr. Kevin Neels ("KNVS") to refute FTI's attacks on CE Approach.

To summarize, Dr. Neels explains that (1) the contribution earned by UP and KCS cannot be measured without accounting for the switch movements that take place on the Lead; (2) FTI's incorporation of fixed costs into the CE calculation is internally inconsistent and wrong; (3) BNSF has presented no valid legal, economic, or conceptual basis for further reducing SSW compensation based on the KCS share of earnings; (4) FTI's attacks on Dr. Neels' use of an enterprise-value based multiple approach are based on mischaracterizations and wrong; and (5) use of railroad cost of capital to capitalize Lead contribution does not yield a result that reflects the full market value of the assets comprising the Lead. See KNVS at 1-6. Dr. Neels puts it best when he describes FTI's critiques of Dr. Neels' CE-Based SSW compensation as broadly speaking, flawed, and without merit.

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II. BNSF's Arguments To Avoid Paying Either SSW Or A Market-Based Fee Should Be Rejected

BNSF's arguments, which seek to reduce the compensation due for trackage rights on the Lead, should be rejected for several reasons. First, in BNSF's opinion, "BNSF is not using any of the property rights possessed by KCS under partial ownership of the trackage....," thus "KCS is due no interest rental compensation." See BNSF Opening at 15. KCS has already explained why this argument is flawed as a matter of Louisiana property law. See KCS Reply at 19. The rebuttal verified statement of Ms. Marzulla, attached hereto, furthers that argument. BNSF is using KCS property and KCS is entitled to compensation for that property.

Second, BNSF attempts to reduce the second component of SSW by failing to properly calculate maintenance costs and by significantly understating property taxes. Dr. Neels' rebuttal statement explains why this is improper.

Third, BNSF asks the STB to direct KCS and UP to "treat BNSF as it were UP"¹³ and maintain the existing cost-sharing arrangement between UP and KCS, claiming that satisfies the objectives of SSW. Such an approach ignores both Louisiana property law, the statutory requirement for compensation under condemnation principles, and the reality that such an approach merely perpetuates BNSF's below-market access at the expense of KCS. And while KCS and UP provide service for each other on the Lead, BNSF provides nothing. For decades BNSF

¹³ BNSF provides no evidence whatsoever to support that for compensation purposes, KCS is entitled to no more for BNSF's use of the terminal trackage rights than KCS would be owed for UP movements on the Lead. BNSF is not UP and does not share in maintenance costs with or provide switching services to KCS on the Lead as UP does, which formed the basis, in part, for why UP and KCS agreed to a cost-based reciprocal switching approach decades ago. Under BNSF's proposal, it would not share responsibility for maintaining the Lead, would not invest in additional infrastructure, nor would it provide reciprocal switching service, responsibilities UP and KCS have shared for decades. BNSF's proposal completely disregards the statutory requirement that KCS should be compensated for BNSF's use of KCS's property.

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has had a competitive advantage over the Lead. BNSF's proposal seeks to extend this existing "free ride" into perpetuity.¹⁴ The STB should reject this request.

Fourth, BNSF has argued throughout this proceeding that it should pay no more than the Prescribed Fee, and any compensation due to KCS should be borne by UP. BNSF Reply at 3. This proposal turns the statute on its head. The statute is clear that since BNSF is the party seeking access, BNSF alone should be responsible for paying compensation to the owner[s], in this case, UP and KCS, for the terminal facility access that it seeks. Collectively, BNSF's proposals are crafted to understate the real-world commercial value of the Lead and have KCS and UP continue to subsidize BNSF's operations so that BNSF can earn higher revenues.

CONCLUSION

The evidence in the record leaves the STB two paths: adopt KCS's market-based rate calculated by Prof. Carey - the only approach consistent with the Fifth Amendment and Louisiana property law - or use the evidence in the record to calculate SSW compensation, even though this standard is not consistent with condemnation principles. In undertaking its task, the STB should pay careful attention to the fact that BNSF's proposals are laced with errors and are based on self-serving, results-oriented assumptions that are not grounded in law or economics. What BNSF proposes would not fully compensate for what KCS would lose by BNSF's terminal trackage rights. The application of SSW itself is also deeply flawed because it does not account for the fact that BNSF has already had reciprocal switching/ haulage access based on paying the sub-SSW "Prescribed Fee" since 1996. This access has resulted in lower than market

¹⁴ Whatever the arrangements between the Lead's owners, who bear the costs of ownership, operation, and maintenance of the Lead, they are irrelevant to non-owner BNSF who avoids those responsibilities, and they do not change the requirements of Section 11102(a).

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contribution to KCS's and UP's off-network costs, which artificially depress any SSW calculation.

If the STB accepts many of BNSF's arguments in this phase of this proceeding, the STB will continue to provide BNSF with access at below-market rates inconsistent with the statute and continue to drain needed contribution away from KCS, who remains a revenue inadequate carrier. BNSF's proposals, coupled with Decision No. 8, will give BNSF substantial operational and cost advantages, subsidized by KCS and UP. Those advantages will make it extremely difficult for UP and KCS to compete with BNSF, allowing BNSF to put more money in its pocket due to its advantaged competitive position. The un-level playing field that BNSF wants will serve only BNSF, not competition, and not shippers on the Lead.

Respectfully submitted,

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May 11, 2021

Attorneys for The Kansas City Southern
Railway Company

In this VS, I respond to BNSF's Reply and urge the Board to use just compensation as the measure of compensation, consistent with Title 49, Section 11102, and Fifth Amendment case law.

1. BNSF's first argument that this is not a condemnation proceeding turns the statute on its head and ignores Congress' mandate.

BNSF completely ignores the fact that the Board is statutorily required to "establish conditions and compensation for use of the facilities under the principle controlling compensation in condemnation proceedings."¹ As explained in my original VS, the principle governing compensation in condemnation cases is the Fifth Amendment's just compensation requirement.² BNSF's refusal to acknowledge that just compensation is the bedrock principle applied in condemnation proceedings, and thus the rule governing compensation in this proceeding, sweeps away BNSF's argument that the Board should award KCS anything less than just compensation. BNSF's argument that the Board should instead use a formula based on costs and capital fails because it is not the measure of just compensation governing condemnation cases. BNSF cites no condemnation case using SSW because the SSW formula is not applied in condemnation cases.

2. BNSF's second argument regarding exclusivity and the effect of the use of the Rosebluff Lead on KCS's trackage rights is based on a misunderstanding of property law

"Exclusive" refers to what the Supreme Court has termed "the landowner's right to exclude, one of the most essential sticks in the bundle of rights that are commonly characterized as property."³ Moreover, "[a]n exclusive right or privilege, is one granted to a person to do a thing, and forbidding all others to do the same."⁴ Further, the right to exclude is widely considered the *sine qua non* of the institution of property.⁵ "In other words, without the right to exclude, there can be no

¹ 49 U.S.C. § 11102(a); *see also* S.T.B. Decision, FD 32760, slip op. at 3, 11 (Feb. 21, 2020).

² VS of N. Marzulla at 2-5 (Jan. 26, 2021).

³ *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 433 (1982).

⁴ *Exclusive*, Bouvier's Law Dictionary (revised 6th ed. 1856).

⁵ Thomas W. Merrill, *Property and the Right to Exclude*, 77 Neb. L. Rev. 730, 730 (1998).

property.”⁶ Before the Board granted BNSF trackage rights, KCS and UP jointly held the exclusive right to use the Lead and the right to exclude all others. Even in common usage, “exclusive” does not mean that a right is held by only one person. An exclusive club does not have only one member, nor is an exclusive invitation extended to only one invitee. Exclusive means “limiting or limited to possession, control, or use by a single individual or group.”⁷ There is no support for BNSF’s argument that KCS’s right to just compensation in a condemnation proceeding—and thus KCS’s right to just compensation here—disappears simply because KCS jointly owns the Rosebluff Lead.

3. BNSF’s third argument regarding fair market value is misguided.

BNSF is simply wrong in contending that just compensation, a compensation standard defined in thousands of condemnation proceedings, provides no measure of compensation here. Just compensation is customarily defined as fair market value.⁸ Fair market value is “the amount of money ‘which a purchaser willing but not obliged to buy the property would pay to an owner willing but not obliged to sell it, taking into consideration all uses for which the land was suited and might in reason be applied.’”⁹ Determining the fair market value is a subject for experts in valuation like appraisers or economists, pursuant to the Federal Uniform Standards for Federal Land Acquisitions, which prescribes appraisal standards for all federal land acquisitions.¹⁰ I understand one of KCS’s other witnesses in this proceeding has proposed compensation intended to ensure that BNSF pays fair market value for the access it seeks.

VERIFICATION

I, Nancie G. Marzulla, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified to submit this Verified Rebuttal Statement.

Executed on May 3, 2021



⁶ Thomas W. Merrill, *Property and the Right to Exclude II*, 3 Brigham-Kanner Prop. Rts. Conf. J. 1 (2014).

⁷ “Exclusive.” Merriam-Webster.com Dictionary, Merriam-Webster.

⁸ See *Horne v. Dep’t of Agric.*, 576 U.S. 350, 368-69 (2015).

⁹ *Grand River Dam Auth. v. Grand-Hydro*, 335 U.S. 359, 367 (1948).

¹⁰ Interagency Land Acquisition Conference, Uniform Appraisal Standards for Federal Land Acquisitions (2016).

I. INTRODUCTION AND SUMMARY CONCLUSIONS

I Julie M. Carey filed Verified Statements (“VS”) in the prior rounds of the above-captioned case during opening (“JCO”) and reply (“JCR”). I am responding to the Reply VS of Mike Baranowski (“FTI R.”) and Dr. David Reishus (“Reishus”), identified in the legal brief (at ii). I find the FTI and Reishus criticisms to be unsupported or otherwise without merit. My proposed market-based access fee best reflects fair market value outcomes where BNSF and KCS share contribution as they would but for the forced access. The market-based access fee uses 2,000 switching rates from real-world commercial negotiations with willing buyers and sellers for similar markets/railroad services (less switching costs)¹

II. RESPONSE TO FTI**A. Claim that KCS’s [REDACTED] contribution over 22 yrs. supports a conclusion of no revenue suppression since BNSF’s access is belied by market share statistics and other technical errors.**

FTI claims that KCS’s contribution from Lake Charles chemical shipments has [REDACTED] [REDACTED] from 1994 through 2016 and suggests this demonstrates that BNSF’s access has not suppressed KCS revenue from the Rosebluff Lead (“Lead”) (FTI R. pp. 23-24.). First, FTI’s analysis fails to account for inflation, and when corrected, KCS’s Lake Charles contribution shows [REDACTED], contrary to his conclusions.² Further, the sweeping conclusion is based on a single piece of information. FTI (and Reishus) fails to analyze the market competitors and all railroad services, including the [REDACTED] volumes, revenues, and contributions BNSF has achieved with [REDACTED] market share. Distinctly, I analyzed competitors’ businesses over time (including market shares) to understand the competitive impact metrics, that I and other economists routinely use for competition analyses. Neither Reishus nor

¹ JCO pp. 4-5. An average customer rate equal to \$490 /car, which is reduced by an estimated switching cost for Lake Charles movements to Lyondell equal to [REDACTED] car for Zone 2 (Lyondell) to derive the appropriate market-based access fee for BNSF to directly access Lyondell equal to [REDACTED] car for Zone 2 (Lyondell).

² See JC WP [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

FTI evaluates the market but for BNSF's undue economic advantage (analyses that I presented which both completely ignore). My prior analysis shows that BNSF's market share was [REDACTED] vs. [REDACTED] for KCS for the 2017-2020 period for customers on the Lead.³

FTI ignores: (1) widely accepted [REDACTED] in the overall railroad chemical and plastics industry expansion,⁴ and (2) economic opportunities from reliance on storage in transit facilities ("SITs") which provide second leg movements and substantial contributions.^{5,6}

B. FTI argues KCS is doing well enough financially and implicitly suggests the Board should ignore the fact that BNSF is generally revenue adequate and KCS is not.

FTI ignores BNSF's large contribution and profits garnered through its undue economic advantage, below market access rate, and the economic reality that BNSF's benefit has come at the expense of and directly caused harm to KCS through denied network contribution⁷ (forced despite its owned property). Further, FTI ignores the fact that KCS has a historical earnings shortfall while BNSF has not from the STB's revenue adequacy test. In fact, BNSF's return on investment ("ROI") was approximately 50% higher than KCS's for the 2010-2019 period (BNSF = 12.06% KCS = 8.17%).⁸

FTI suggests that his SSW rate (based on RCNLD) is sufficient because the Interest Rental ("IR") exceeds the average IR per route-mile that would result in system revenue adequacy.⁹ (FTI R. pp. 29-30). However, it is unreasonable to compare his IR to systemwide average IR because doing so (1) assumes all rail services are the same (which they are not) and (2) implicitly assumes that all customers can bear

³ See JCO pp. 24-27 and JCO Exh. 3 for discussion and market shares. See JCO Exh. 2 for Lake Charles strategy.

⁴ BNSF internal documents show [REDACTED] See BNSF, "Plastics Overview", June 18, 2020, "Chemicals & Plastics ROIC/Price", p. 3 at BNSF-LC-2020-0000773 from BNSF-LC-2020-0000759-799.

⁵ BNSF states that [REDACTED] See BNSF, "SIT Expansion Proposal," p. 2, "Plastics Growth" at BNSF-LC2020-0008669 from BNSF-LC2020-0008668-86.

⁶ I discussed the strategic importance of SITs and contributions beyond an SSW rate (based on RCNLD and CE) in JCR Sec. II.C. The same criticisms apply to FTI's SAC submitted in FTI R.

⁷ JCO pp. 2-3, 10 and JCR Secs. I and IV.

⁸ See JCO p. 9, Figure 1. A cursory review demonstrates the relative trade-off between contribution to either the BNSF or KCS network. BNSF has been deemed revenue adequate 8/10 years compared to KCS 0/10 years.

⁹ The latter is calculated as KCS R-1 Interest Rental per Route-mile = (KCS Total System Net Valuation × Industry Pre-Tax Cost of Capital) ÷ KCS Total System Miles. See FTI R. p. 31, Table 6.

average costs (inconsistent with the Board’s application of the RSAM markup) that should be born only by a subset of customers (i.e. not all customers) with RVCs above 180%).¹⁰ To illustrate, if \$100 million of underearnings (revenue inadequacy) is spread over systemwide traffic of 1 million cars, each car would need to bear \$100 of additional cost to reach systemwide revenue adequacy. However, if only 50% of systemwide traffic can bear additional cost then that subset must bear twice the systemwide average in additional cost—specifically, \$200 per car.¹¹ Simply put, FTI’s comparison is invalid and way too low. In addition, as discussed in JCR Secs. III and IV, FTI’s IR based on RCNLD is dramatically understated and a market-based fee is superior.

Further, FTI’s claim that KCS’s systemwide revenue inadequacy masks success contributed by the Lead is flawed for the same reasons the analyses discussed above (Section II.A).¹² He asserts that the Lead has a [REDACTED] R/VC traffic which contributes more to revenue adequacy, and that chemical shipments with R/VCs above 180% have [REDACTED].¹³ However, FTI’s study combines various products (not acknowledged in his report), and if one analyzes [REDACTED]
[REDACTED]]¹⁴

Additionally, the study’s reliance on cherry-picked movements and dates further makes it unreliable.¹⁵

C. FTI’s critique of my market-based access fee includes criticisms that either are de minimis, unsupported, without merit or inconsistent with BNSF’s expressed views.

¹⁰ Simplified Standards for Rail Rate Cases, 689 (Sub-No. 12), slip op. at 1 (Served December 30, 2020) (“EP 689”).

¹¹ However, this is more extreme for KCS. 35% of KCS 2019 total revenue came from revenue where RVC is above 180%, implying that even less traffic is able to bear additional cost above the systemwide average. (\$427,259,465/\$1,208,324,625=0.35) See Workbook filed with EP 689 entitled “Notice Simplified Standards for Rail Rate Cases, EP 689 (Sub-No.12) RSAM-COMP-2019.xlsx”, tab “RSAM_2019_Class_I_Costs_and_Rev.”

¹² Including the (1) dramatically understated RCNLD estimation, (2) inability of such a rate to capture value from second leg movements from SITs and other economic value represented by a market-based fee that are discussed in JCR Secs. II.C. and III, and (3) FTI’s failure to present any analysis of competitive effects to the contrary.

¹³ FTI R. pp. 31-32. See FTI R. WP “CWS Analysis.xlsx”, tab “Tables.”

¹⁴ See JC [REDACTED]

¹⁵ [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]]

First, I did not improperly exclude reciprocal switching rates as FTI claimed. (FTI R. pp. 38-39) Nevertheless, including the claimed improper rates has a de minimis impact.¹⁶

Second, FTI claims that I bias rates upward and should exclude non-BNSF, UP, and KCS railroads in my reciprocal switching rate analysis. (FTI R. pp. 35-37). First, there is no a priori reason that KCS would or should limit themselves to negotiate with BNSF based only on benchmark switching rates of 3 railroads (instead of all Class 1 railroads) in any commercial negotiations, particularly when publicly available data for similar railroad services exist.¹⁷ Indeed, non-BNSF/UP/KCS switch rates are reported in many of the geographic markets for the services that I analyze (JCO Ex 5). Also, as I discussed and is recognized by FTI R. and Reishus R., the Board has acknowledged the comparable line segment approach for trackage rate cases, which is reasonably similar to my approach that selects the same railroad service to identify the “value of the assets in the marketplace.”¹⁸ In addition, KCS has negotiated much higher reciprocal switching rates than the \$490/car weighted average rate from my study, and as high as [REDACTED] including rates negotiated with BNSF and UP.¹⁹ Notably, FTI (or Reishus) could have attempted to support the upward bias claim with a sensitivity analysis excluding a subset of my data (to show the impact thereof). However, it’s not surprising that they did not do so, as I used a large sample size of 2,000 reciprocal switching rates to ensure reliable and stable results of the average value for the group of comparable markets. To highlight the unfounded claimed upward bias, consider the subset of higher-end rates that could potentially cause upward bias (i.e. above \$490/car weighted average

¹⁶ Their inclusion changes the results by less than one tenth of one percent. (i.e., a .006 difference) See JC WP “Exc Comm Reciprocal Switch Rate Analysis.xlsx”, tab “Summary.”

¹⁷ Reciprocal switch rates are generally publicly available. For example, see CSXT (<https://www.csx.com/index.cfm/customers/publications-tariffs/the-csxt-8100-publication/>) and NS (<http://www.nscorp.com/content/nscorp/en/transportation-terms/other-requirements/switching-and-absorption-rules-and-charges.html>); This is distinct from confidential third party railroad contracts which may be impossible to obtain in certain disputes and raise confidentiality concerns to avoid competing carriers from viewing confidential third party railroad contracts. See U.S. STB, Simplified Standards for Rail Rate Cases Decision, Ex Parte No. 646 (Sub- No. 1), September 4, 2007, p. 82.

¹⁸ The STB has acknowledged that a comparable line segment approach is an acceptable method to determine the valuation base for the IR component. See JCO p. 22, n. 65 and JCR Sec IV, FTI O. p. 18 and Reishus R. p. 17.

¹⁹ See JCO at Exhibit 5 pp. 8, 12-13, 20-22. [REDACTED]

rate). Excluding CSXT, NS, CP, and CN increase the avg. rate to approx. [REDACTED]]
(with all railroads) contrary to claimed bias.^{20, 21}

Relatedly, FTI provides no analysis to support his claims that cost differences among various rail carriers and regions account for the wider range in rates.²² The type of railroad service is the predominant factor impacting the switch rate and not the specific railroad or region as FTI suggests.²³ Indeed, my opening analysis controls for the primary distinguishing factors including the specific railroad services in the market area and only large comparable railroads (only Class 1).²⁴ In support of my selection of market areas, I conducted a specific geographic market analysis that was not critiqued.²⁵ Controlling for key factors to ensure reasonable similarity (as my approach does) is consistent with academic literature on comparables analyses for valuation and other financial analyses (which consider similar product offerings and services, markets, the nature of competition among other factors).²⁶

Third, FTI argues that my approach is flawed because in his view the reciprocal switching relies on cost-based rates and is not a market-based regime. (FTI R. pp. 32-33) He relies on only 3 cited examples (including a 1985 citation) and no real-world examples from his client, BNSF.²⁷ The inclusion of a few cost-based rates makes my analysis conservative.

²⁰ See JC WP HC “Above average Rates”, tab “Summary.” Similarly, if I exclude outlier regions with higher rates or lower rates, my resulting rate is approximately the same.

²¹ A range of rates in the market is what economic bargaining theory expects for commercial negotiations (as stated in JCO and ignored by FTI who provides no real-world examples from his client, BNSF). See JCO pp. 23-24.

²² FTI R. p. 37

²³ See JC WP “Average Reciprocal Switch Price Variants.xlsx”, tab “Average Recip Switch.”

²⁴ See JCO pp. 35-38.

²⁵ See JCO Exhibit 4 and JCO WP “HC 00011(Exhibit 4 Geographic area product analysis).xls”, tab “Origin Comparison.”

²⁶ Shannon Pratt and Alina V. Niculita, “Valuing a Business: The Analysis and Appraisal of Closely Held Companies”, 5th ed., 2008, pp. 265-272; Tim Koller, Marc Goedhart and David Wessels, Valuation: Measuring and Managing the Value of Companies, 7th ed., 2020, p. 382; Shannon Pratt and Alina V. Niculita, The Lawyer’s Business Valuation Handbook, 2nd ed., 2010, p. 25.

²⁷ FTI could have supplied evidence from BNSF’s reciprocal switching rate book, which contains [REDACTED] of the 1,925 rates included in my study, to support his contention that all rates are cost-based. See JCO WP “HC 00012 (Priv Exhibit 5 Class 1 Reciprocal Switching Rate analysis).xlsx”, tabs “Lake Charles Region” through “Wichita region.”

Fourth, FTI attempts to recast BNSF's statements and views expressed in EP 711. (FTI R. pp. 34-35) suggesting they are not applicable here. In EP 711 BNSF argued vigorously to maintain the market-based mechanisms and acknowledged that competition and competitive market prices are key success factors in the railroad industry.²⁸ BNSF's expressed views in support of competition (instead of forced access) are one and the same as supporting market-based and negotiated rates and differential pricing in which the railroad industry has been rooted since the Staggers Act.²⁹

Fifth, FTI either misinterprets (or misrepresents) the distances reported in my reciprocal switch rate study, which are solely cosmetic presentational guides to aid the reader's understanding of the geographic region (i.e. not used in my analysis). Indeed, his statements are erroneous (FTI R. pp. 40-42) because the mileages do not represent the distance of the trackage or switch operation.³⁰

Sixth, FTI argues that since average switch rates for BNSF, UP and KCS approximate the URCS fully allocated costs (FAC) there is no market-based contribution, and therefore the RSAM based rate should be rejected. (FTI R. pp. 39-42) This analysis is disingenuous as URCS FAC provides a substantial contribution margin above variable costs that support the broader railroad network.³¹ The relevant contribution above variable cost that BNSF has derived and KCS has been denied is the key issue in this case.³² Further, there is not a "one size fits all" reciprocal switching market but rather a wide

²⁸ See JCO pp. 7-8. FTI asserts that I baselessly attribute railroads' statements in support of market-based outcomes in a forced switching context to the real-world market based reciprocal switch rates I rely upon. (FTI R. pp. 34-35).

²⁹ See JCO pp. 20-22 and n. 51.

³⁰ The distances stated in JCO WP "HC 00012 (Priv Exhibit 5 Class 1 Reciprocal Switching Rate analysis).xlsx, tab "Cities Included in Region" represent the distance between the railroad listed switch location and the city used as the region title in the analysis. For actual distance between the switch yard and customer for the Mobile, AL switches cited by FTI. See JC WP "Station Dist Analysis.xlsx", tab "Mobile Region."

³¹ I generally use the term contribution to describe revenue less variable cost. See JCO p.4, n.5.

³² For example, using FTI's URCS costs at face value, the average variable cost of the switch rates he calculated is \$211, therefore leaving \$114 as contribution to fixed costs within the network. See FTI R. WP "2019 URCS Industry Switch Costs-C2.xlsx", tab "2019 URCS Industry Switch Costs." Further, it appears FTI used URCS data tables set to full 100% flow-through mode and applied a constant cost-markup ratio to the total cost, thus double counting the full allocation of variable costs and therefore improperly inflating costs. Additionally, he fails to provide rationale for his chosen user inputs the URCS calculation. Using different parameters leads to different results and it is unclear that FTI's are the correct ones.

range of rates in the market³³ which are also associated with a commensurate range in contribution margins that each address the specific market circumstances. Lastly, my URCS cost deduction is conservative.³⁴

Seventh, FTI offers incomplete opinions on KCS's competitiveness (which he claims is [[REDACTED]] of the lanes) based on the limited sample of contribution data.³⁵ (FTI R. pp. 44-45.) Notably, he didn't evaluate important second leg moves relied on by a substantial amount of the customers or evaluate the entire relevant historical period or other means to assess the real economic harm to KCS. This is inadequate, says nothing about competition or undue advantage to BNSF and the substantial economic harm to KCS that I quantified as BNSF's nearly [[REDACTED]] carloads and estimated [[REDACTED]] market share in 2019, and the [[REDACTED]] contribution margins for competitive customer locations—all are points to which neither FTI nor Reishus responded.³⁶

D. FTI's Woefully Inadequate Alternative SAC First Year Capital Recovery Using Replacement Cost New is Flawed for the Same Reasons his RCNLD is flawed.

FTI suggests the IR would be approximately 23% lower for an SSW rate (based on SAC) as compared to an SSW rate (based on RCNLD). (FTI R. pp. 5, 27-28, Table 4) First, as I discuss in JCR, FTI's RCNLD is dramatically understated (with numerous corrections that more than quadruple to rate from \$2.98 to \$15.97 per car-mile).³⁷ I did not quantify the impact of all identified errors.³⁸ This rate is slightly decreased by adopting the lower road property estimate as updated in FTI R.³⁹ The illustrative

³³ For example, BNSF switching rates range from [[REDACTED]] to [[REDACTED]]. See BNSF-LC-2020-HC-0009750-71, at LC-2020-HC-0009759 and LC-2020-HC-0009769.

³⁴ URCS includes depreciation and ROI for multiple cost categories, including car and train mile costs, locomotive costs, and gross ton-mile expenses. See <https://prod.stb.gov/reports-data/uniform-rail-costing-system/>.

³⁵ This data is limited to a [[REDACTED]] bids produced in discovery and not all customers on the Lead.

³⁶ JCO pp. 26-28.

³⁷ Also, [[REDACTED]]. See JCR Section III pp. 13-20. I quantified the impact of correcting 4 areas of concern. (1) Understated inflation to road property investment (2) Fails to include reflect interest during construction and future replacement road property costs; (3) Full Commercial Value of the New Asset (4) Restore 100% of the Valuation of the Lead.

³⁸ Dr. Neels identified that Operations and Maintenance costs and property taxes were also too low (and therefore the IRF was further restated even with my adjustments.) See KNR Secs. V.a and V.d

³⁹ See JC WP "Compensation Calculations_Adjusted_Update.xlsx."

SAC presented by FTI is a manufactured variant of the RCNLD IR (i.e. RCNLD is the SAC input) and therefore suffers from virtually all of the same issues that I identified in JCR for RCNLD.⁴⁰

III. RESPONSE TO REISHUS

Reishus argues that my framework involves establishing access and ignores the fact that BNSF already has access to Lake Charles customers and that UP's cost-sharing agreement should be sufficient, and asserts that SSW is appropriate in the alternative. (Reishus R. pp. 9-12, 17-18) I disagree. BNSF never received negotiated access from the joint owner of the asset (KCS). Further, my approach of a market-based access fee is appropriate and reasonably similar to the SSW comparable line value approach the Board indicates is acceptable.⁴¹ Absent the Board's mandate, KCS would have demanded a market-based rate in which parties share in the contribution to the benefit of both networks. KCS would not have accepted a cost-based rate that gives BNSF 100% contribution for BNSF's [[REDACTED]] market share vs KCS's [[REDACTED]] (Sect. II.A above). As I discussed, in the JCO SSW rates (based on RCNLD and based on CE) are inadequate and dramatically understated. See JCO pp. 24-32.

Next, Reishus suggests the "market value" requested by KCS is far in excess of the incremental value of the trackage rights. (Reishus R. p. 13-15.) First, there is no support for an incremental value estimate in this case and none has been proposed. Second, the analysis is inconsistent with the real-world contribution margin analysis by [[REDACTED]]⁴² In addition, without any supporting analysis, Reishus suggests that if the rate is too high BNSF won't

⁴⁰ FTI R. p. 28, Table 4. FTI also includes an alternative SAC analysis that removes the historical depreciation and includes an understated estimate of PV of replacement costs (only 4.7% (\$1.4/\$30 mill) vs 8.1%)) akin to a traditional SAC, which increases the IR by approximately 25% above the RCNLD-based SAC analysis. However, it too is flawed for many of the reasons I state in JCR and reference in footnote 37. See FTI R. WP "Rosebluff DCF Replacement Cost New.xlsm." FTI R. WP "Compensation Calculations Reply-c2.xlsx",

⁴¹ See footnote 18.

⁴² [[REDACTED]]
[[REDACTED]]
[[REDACTED]]
[[REDACTED]]

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compete for business (Reishus R. p.15). Indeed, this view is inconsistent with BNSF's [REDACTED] market share (Sect. II.A above). Further, he misrepresents the case at hand; KCS doesn't seek for BNSF to pay for some unsupported claimed loss of market power. KCS seeks a market-based access fee for its jointly owned asset that it would have negotiated for in the exact manner that KCS must negotiate in order to access locations on BNSF's network (which I discussed on opening). See JCO pp. 3-5.

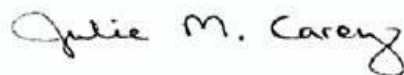
Further, Dr. Reishus argues that determining "valid" arms-length agreements includes "significant, broad issues" and then makes the unsubstantiated claim that the presumption of arms-length switching rates is inappropriate. See Reishus R. p 19-24. He provides no data, evidence, analysis, or any real-world examples from his client, that the switching rates in my analysis are not the result of arms-length negotiations.⁴³ Indeed, competitive negotiations are the cornerstone of the railroad industry and it is expected the parties negotiate rates in the first instance. Such rates are routinely assumed by the STB, courts, and other agencies to be fair market value arms-length transactions. See JCO p 20-22, n. 51)

Finally, Reishus's claims (Reishus R pp. 24-26) that a range of switch rates leads to unreliable results are flatly unsupported as discussed in Sect. II.C above. Commercial negotiations result in a range of market-rate outcomes. (JCO pp. 23-24) to which Reishus identified no key factors that are not already controlled by reliance on a large data set and average results which capture overall market performance. I did not try to cull the data to engineer the highest value but instead gathered as much comparable data possible to let the data speak for itself by selecting the unbiased average value.

VERIFICATION

I, Julie M. Carey, declare under penalty of perjury that I have read the foregoing Verified Statement, that I know the facts asserted therein, and that the same are true as stated. Further, I certify that I am qualified to and authorized to submit this Verified Statement.

Executed on May 11, 2021



⁴³ Ironically, the only switching agreement that he points to is the BNSF/UP agreement (Reishus R. p. 20), and states "[i]n this context, there has been an arm's-length transaction between BNSF and UP resulting in a price (the Prescribed Fee) for BNSF's direct "access" to the Lead." This reference is highly misleading and incomplete as this agreement was distinct and not comparable because UP received tremendous benefits associated with the UP/SP merger that was necessitated by agreeing to give BNSF access to the Lead and other locations.

I, Dr. Kevin Neels, filed Verified Statements (“VS”) during the opening and reply stages (“KN Reply”). Similarly, I will refer to Professor Julie M. Carey as Carey. I am responding here to the Reply VS of Mr. Mike Baranowski (“FTI”), identified in the legal brief, which I refer to as FTI R.

I. The Contribution Earned by UP and KCS Cannot Be Measured Accurately without Taking into Account the Switch Movements Taking Place on the Lead.

FTI criticizes the inclusion in my calculations of the contribution generated by UP and KCS switch movements performed for each other. He refers to this contribution as “artificial” and offers an extensive criticism of the URCS costing used in my calculations. FTI R. at 16-18. However, he offers no suggestions regarding how these cost calculations might be improved or made more accurate. Instead, he argues that because the rates paid for these switch movements are supposed to be cost-based, there is, by definition, no contribution associated with them and that any contribution associated with these movements should be eliminated. In the paragraphs below, I explain why FTI is mistaken.

First, there is nothing “artificial” about these switch movements. They reflect the actual movement of freight on Rosebluff Lead (“Lead”). Ignoring these movements is equivalent to assuming that all KCS shipments involving Zone 2 customers and all UP shipments involving Zone 1 customers simply terminate in the Rosebluff Yard, which is clearly not accurate.

Second, while I am aware of the many limitations and inaccuracies of URCS, it is the STB’s official regulatory costing system. In sanctioning the use of URCS for this purpose, the STB has weighed URCS’ limitations against the benefits of having a readily available costing system that all parties can use.¹ The STB maintains that the benefits of URCS outweigh its costs.

¹ In Ex Parte 657, the STB weighed the merits of permitting parties in SAC based rate reasonableness cases to make movement specific adjustments to URCS costs. It concluded that “we do not believe that the use of movement-specific adjustments leads to a more accurate result than using the URCS system-wide average.” See Major Issues In Rail Rate Cases, EP 657 (Sub-No. 1), slip op. at 51 (S.T.B. served October 30, 2006).

Third, while it is true that UP and KCS agreed, as owners, that the switch fees they charged to each other would be cost-based, this agreement does not extend to third parties. Indeed, the owners' agreements prohibited either owner from giving a third-party access to the Lead without the written approval of the other owner. Although the owner switch fees are supposed to be cost-based, it is also true, as FTI points out, that the last time these rates were benchmarked to actual costs was in 2004 – 17 years ago. See FTI R at 19. Over the ensuing two decades, switching rates have only undergone periodic formulaic adjustments, and have had ample opportunity to drift apart from actual costs.

II. FTI's Incorporation of Fixed Costs into the CE-Based Calculation of SSW Is Internally Inconsistent and Clearly Wrong.

In my SSW calculation, I computed the Lead contribution earned by subtracting the variable costs associated with UP and KCS Lead movements from their revenues. This corresponds to the generally understood interpretation of the term "contribution." To be consistent, I calculated the same variable cost-based measure for all of UP and KCS's US operations. To derive valuation multipliers, I divided the U.S. enterprise values of UP and KCS by the contribution earned on their U.S. operations.

In contrast, FTI's fixed cost adjustment is a mongrel calculation that combines inconsistently derived measures into a result that is conceptually and economically meaningless. He first calculates a measure of Lead earnings by subtracting the fully allocated costs associated with UP and KCS movements along the Lead from the revenues associated with those same movements. However, he then capitalizes this measure using my original multipliers based on the difference between revenues and variable costs for all UP and KCS operations – an inconsistent, and thus overtly flawed, approach.

If I believed that this valuation calculation should be based on fully allocated costs rather than variable costs – which I do not – the correct way to determine the effect of such a change would require recomputation of multipliers using the difference between total transportation revenues and total fully allocated cost. The latter number would, of course, be much smaller than the difference between revenue and variable cost and, when divided into the enterprise value number, would yield a

much higher valuation multiplier. Multiplying a smaller earnings measure by this higher valuation multiplier would essentially reproduce my original result.

III. There Is No Valid Basis for Reducing SSW Based on the KCS Share of Earnings

Although UP and KCS have a joint and undivided ownership interest in the Rosebluff Yard and the Lead,² FTI has repeatedly sought to create an artificial distinction between UP's property rights and KCS's property rights.³ See Opening VS of Mr. Mike Baranowski ("FTI O.") at 15. In the FTI O., he divided his calculated SSW in half, arguing that as a joint owner KCS is owed no more than that amount. As noted in KNR, however, that split is not for FTI to decide. The Lead is a single facility requiring a single fee for access, and it is up to its owners to decide how that fee should be distributed.⁴

FTI R. proposes a new way of reducing the SSW owed to KCS, arguing that the full fee should be split between UP and KCS based on the contribution that each generates from its traffic on the Lead. See FTI R. at 22. This new approach assigns a much smaller share of total SSW to KCS than even the initially proposed 50/50 split. FTI offers no justification for this new approach other than his unsupported opinion that it is the "correct" approach, irrespective of the fact that there is no valid legal, economic or conceptual basis for this division. The STB should reject it.

IV. FTI's Criticisms of My Enterprise-Value Based Multiplier Approach Are Based upon Mischaracterizations

FTI offers several criticisms of my Enterprise Value multiplier. He states first that my approach "is founded on the faulty premise that enterprise valuations are proportional to physical asset historical gross book values." He also asserts that I attribute "the profitability and growth characteristics assumed for the KCS and UP systems to the profitability and growth characteristics of the [Lead]." Lastly, he argues that statements by Carey and myself that "existing and future revenues for shipments

² See KCS's Reply (Filed April 12, 2021), at 10.

³ See Opening VS of Mr. Mike Baranowski ("FTI O.") at 15.

⁴ See KCS's Reply, Exhibit C, Reply Verified Statement of Dr. Kevin Neels ("KN R."), at 111.

originating and terminating on the [Lead] are suppressed by BNSF access” is “counter to the growth prospects embedded in the enterprise value.”⁵ None of these criticisms is valid.

First, my approach does not rest upon any broad or overarching assumption regarding the proportionality of gross book value and enterprise value. Valuations under my approach are established by the market values of the equity and debt of the two railroads. My calculation uses book values only for two limited purposes: to separate the values of KCS’s U.S. and Mexico operations, and to separate, for both KCS and UP, the values of the “below the wheel” assets from the values of the “above the wheel” assets that BNSF would not be using. For these limited purposes, the use of gross book value is entirely appropriate. The road property investments that make up the “below the wheel” assets are geographically immobile and thus serve as the value anchors for the various geographic divisions of the KCS and UP networks.

More generally, even though gross book value is not a perfect measure of value, one would certainly expect it to be closely related to value. If this were not true, why would large companies devote substantial effort and expense to tracking and reporting the book values of their assets?

The gross book value measure that FTI criticizes is closely related to the SAC measure that he endorses. Under SAC, the values of assets are set at their current replacement costs. The primary difference between SAC and gross book value is that the latter measure values of assets at their original acquisition costs, and so does not account for the effects of subsequent inflation.

The effect of the relative “staleness” of the prices at which gross book values are recorded actually imparts a *downward* bias to my results. The road property assets that my valuation focuses

⁵ Id., at 23.

upon tend to have much longer lives than equipment assets, and hence tend to be recorded at older and lower prices, imparting downward bias into the calculation of the “below the wheel” asset shares.⁶

FTI’s statement that I attribute “the profitability and growth characteristics assumed for the KCS and UP systems to the profitability and growth characteristics of the [Lead]” is simply incorrect. I calculate Lead profitability based on the costs and revenues of Lead traffic. In no sense do I merely *assume* that Lead profitability is the same as the overall profitability of KCS or UP.

FTI is also incorrect in arguing that “existing and future revenues for shipments originating and terminating on the Lead are suppressed by BNSF access” is “counter to the growth prospects embedded in the enterprise value.” While Carey and I agree that the presence of BNSF on the Lead has reduced the rates earned on Lead, we have offered no opinions regarding how that presence affects future *trends* in rates. KCS and UP face substantial competition across their networks. One thus cannot conclude simply from the presence of competition on Lead that growth prospects there will differ materially from those elsewhere.

Although I find that FTI’s criticisms of my Enterprise Value methodology are generally without merit, I have nonetheless tried to consider these arguments carefully to see whether they might suggest ways in which my calculation might be improved, or offer other approaches which the STB may wish to consider. I have described above the reasons why I believe that it is appropriate to split the Enterprise Value of KCS between the U.S. and Mexico based on their respective shares of gross book values. However, if the STB disagrees with this approach, I will note that it is also possible to base this division on the relative shares of transportation revenues earned in the two locations. These shares are reported in the annual 10-K Report produced by KCS. In my workpapers, I present an alternative calculation based upon this approach.

⁶ Per the 2018 R-1 report for KCS, the average annual depreciation rate for road property assets is 2.85%, implying a useful life of over 35 years (Schedule 332). The corresponding figures for equipment assets are 5.27% and approx. 20 years. Thus, gross book values for road property assets will be understated to a greater degree than those of equipment, reducing the road property shares and multiplier values used in my calculation.

V. FTI's Use of the Railroad Cost of Capital to Capitalize Lead Contribution Does Not Yield a Result That Reflects the Full Market Value of the Assets Comprising the Lead.

FTI argues against the enterprise value multiplier approach and asserts instead that capital values should be based on the STB's railroad weighted average cost of capital. FTI's suggested approach simply divides the calculated annual contribution generated by the Lead by the STB's cost of capital to produce a measure of Lead capital value. However, this approach suffers from serious flaws that render it incapable of producing accurate results.

Finance theory states that the net present value of an infinite stream of constant annual payments is equal to the result obtained by dividing the constant annual payment amount by an appropriate discount rate. FTI's suggested approach thus implicitly assumes that Lead contribution will remain constant in nominal terms indefinitely. Such an assumption is unrealistic.

It is much more reasonable to assume that Lead contribution will over time grow at the rate of general inflation. In this case, the correct way to compute the present value of the expected future contribution stream would be to divide the current contribution amount by a *real* interest rate. Such a rate would be equal to the nominal interest rate minus the expected future annual rate of inflation. This conceptually superior approach would produce a larger result than that of FTI.

Yet, even the assumption that the contribution generated by the Lead will remain constant in real terms is unduly pessimistic. In recent decades railroad earnings have grown in real terms, and there is reason to anticipate similar growth on the Lead.⁷

Moreover, even if one were to modify FTI's approach to reflect current rates of inflation and earnings growth, the result would still not necessarily produce a reliable measure of the value of Lead assets. The conceptually correct approach would instead perform these adjustments based upon current market *expectations* regarding future inflation and earnings growth.

⁷ Mr. Pitts' report shows there is land available for new development. Recently, a new shipper located on the Lead. <https://www.1012industryreport.com/petrochemical/lotte-chemical-facility-in-lake-charles-is-now-online/>.

The most reliable way to measure such market expectations is through examination of the values at which income-generating capital assets trade in capital markets. That is exactly what my enterprise value-based approach does. FTI's suggested approach should be rejected.

VI. FTI Cites No Evidence to Support His Assertion of a 1-1 Empty to Loaded Car Ratio

FTI's final modification of my CE calculation changes my empty to loaded car ratio from 0.72 to 1.00. Although he asserts that the value of 1.00 is "the actual empty to load (sic) ratio," he cites no evidence or data to support this assertion, making it impossible to verify.⁸ See FTI R., at 25. In contrast, I based my calculation of car miles on the Lead based upon actual system-wide empty and loaded car-miles, as reported in annual R-1 Reports, a data-driven, and more reliable approach.

VII. CONCLUSION

FTI's critiques of my SSW calculation are, broadly speaking, flawed and without merit. FTI asserts "fact" and "principle" that are unsupported by real-world data, economic and financial principles, or STB precedent. He often asks the STB to believe that something is so simply because he says it is so. My analysis, on the other hand, is based on reliable data sources, and accepted STB principles, tools, and methods. I stand by the compensation evidence presented in KNR. The interest rental component of SSW for BNSF's access to Lyondell should set to \$13.77 per car mile, and the Total SSW set to \$18.88 per car mile. The STB should ignore his critiques of my SSW calculation.

VERIFICATION

I, Dr. Kevin Neels, declare under penalty of perjury that I have read the foregoing Verified Statement, that I know the facts asserted therein, and that the same is true as stated. Further, I certify that I am qualified to and authorized to submit this Verified Statement.



⁸ See FTI R., at 25.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of KCS's Rebuttal Brief was served by first-class mail, postage prepaid, or by a more expeditious manner, this 11th day of May 2021, on counsel for BNSF Railway Company, Union Pacific Railroad Company, and all other parties of record.

/s/ William A. Mullins
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