

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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RAILROAD COST OF	)	
CAPITAL — 2019	)	
	)	STB Docket No. EP 558 (Sub-No. 23)
	)	
	)	

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

By a decision served on February 27, 2020, the Surface Transportation Board (“STB” or “Board”) instituted this proceeding to determine the railroad industry’s cost of capital for the year 2019. The Association of American Railroads (“AAR”) submitted the statement of the railroads on April 20, 2020. The only other interested person to submit comments was the Western Coal Traffic League (“WCTL”), which filed its reply on May 11, 2020.

The AAR reiterates that it followed the Board’s instructions to use the methodology followed in Railroad Cost of Capital – 2018, and WCTL does not dispute that. WCTL admits its “review of the AAR’s filing and the associated workpapers does not reveal any mathematical or associated data errors.”¹ There being no errors in AAR’s calculations, nor any claims that the AAR failed to follow the cost-of-capital calculation methodology set forth in Railroad Cost of Capital – 2018, the Board should determine that the railroads’ cost of capital for 2019 is 9.34 percent.

¹ Reply Statement of Western Coal Traffic League (WCTL), at 1.

I. WCTL’s Collateral Attacks on the Board’s Cost-of-Capital Methodology Should be Rejected

WCTL makes several arguments that boil down to nothing more than complaints about STB’s methodology for calculating the railroad cost of capital. Specifically, WCTL argues that the cost of capital decreased in 2019 from its level in 2018, and blames growth rates in the MSDCF model, claiming this proves “the Board’s methodology is not reliable.”² These claims are nothing more than a collateral attack on the Board’s methodology, properly litigated in the Board’s ongoing proceeding *Revisions to the Board’s Methodology for Determining the Railroad Industry’s Cost of Capital*, EP 664 (Sub-No. 4), as WCTL implicitly recognizes. As it has done in the past, the Board should reject such attacks on its methodology in this proceeding.

WCTL continues to claim the cost of capital should be lower than what was calculated for 2019. As it has done in the past, WCTL cites Morgan Stanley investor reports to claim the railroad cost of capital should be “in the 7% range.”³ WCTL then attempts to buttress the viability of its desired cost of capital by replacing the hybrid methodology with the Capital Asset Pricing Model (CAPM), then manipulating that number with their preferred market risk premium, even though “WCTL accepts that the data [regarding Mr. Gray’s risk premium] is well-regarded and accepted as a source of the historical risk premium.”⁴ In addition, WCTL cites to an interview of the former BNSF Chairman to prove its desired cost of capital is “credible and reliable and that the Board’s hybrid methodology is substantially flawed.”⁵

These claims rehash arguments already rejected by the Board and should be rejected here as well. Previously, the Board has advised that “challenges to the Board’s cost-of-capital

² *Id.* at 2.

³ *Id.*

⁴ *Id.* at 8.

⁵ *Id.* at 3-5.

methodology, such as WCTL’s argument regarding the use of Morgan Stanley’s cost of capital, should be addressed in Docket No. EP 664 ... and not within this annual Docket No. EP 558 proceeding.”⁶ As noted in its prior decision, the Board should “reject[] the notion that the Board’s hybrid approach is improper merely because CAPM and MSDCF may diverge at any given time” as WCTL continues to argue here.⁷ Similarly, the Board should reject WCTL’s market risk premium arguments, not only because in WCTL’s own words AAR’s risk premium is “well-regarded and accepted,” but also because the Board has previously “determined that AAR’s assessment of the market-risk premium complies with the Board’s cost-of-capital methodology.... [and] WCTL’s MRP arguments, disputing the use of the 1926-based MRP, are a challenge to the Board’s cost-of-capital methodology ... [and] the annual determination is not the appropriate forum for such arguments.”⁸ In doing so and by enforcing its precedent, the Board will continue to ensure its division of dockets remains distinct, i.e., “one (Docket No. EP 558 sub-numbered proceedings) for the annual estimate and another (Docket No. EP 664 sub-numbered proceedings) for petitioners to advocate changes to the cost-of-capital model).”⁹ Again, the STB has an open proceeding where such methodological arguments are appropriately made.

II. The AAR Properly Accounted for Operating Leases

In addition, WCTL argues that the AAR should count operating leases as debt, even though GAAP does not require such treatment. WCTL explains that:

⁶ *R.R. Cost of Capital—2016*, EP 558 (Sub-No. 20), slip op. at 9 (STB served Aug. 7, 2017); see *R.R. Cost of Capital—2012*, EP 558 (Sub-No. 16), slip op. at 10 (STB served Aug. 30, 2013); *Methodology to Be Employed in Determining the R.R. Indus. Cost of Capital (Methodology)*, EP 664, slip op. at 18 (STB served Jan. 17, 2008).

⁷ *Id.* at 9.

⁸ *Id.* at 10.

⁹ *Methodology* at 18.

[t]he AAR's position appears to be: (a) operating leases are a balance sheet liability, but still not actual debt, and/or (b) operating leases cannot be treated as debt ... until the Board revises its rules. Neither explanation justifies excluding operating leases from the debt-equity calculation for 2019.¹⁰

Contrary to WCTL's conclusory statement, both explanations justify excluding operating leases from the debt-equity calculation. Not only are operating leases, like other liabilities, properly recorded as a balance sheet liability and not actual debt, but to do otherwise would be a deviation from GAAP, inconsistent with prior Board guidance.¹¹ As noted in AAR's opening statement, "while Generally Accepted Accounting Principles now call for operating leases longer than 12 months to be recorded on the balance sheet as liabilities, that is not synonymous with debt in the context of this proceeding."¹² To imply otherwise is misleading. Therefore, AAR did not include operating leases as debt, but instead as liabilities on the balance sheet.

Conclusion

In sum, WCTL concedes that AAR correctly calculated the cost of capital. Therefore, the Board should determine that the railroads' cost of capital for 2019 is 9.34 percent.

Respectfully submitted,



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¹⁰ WCTL at 5.

¹¹ *Railroad Cost of Capital—2011*, EP 558 (Sub-No. 15) (STB served Sept. 13, 2012), at 17.

¹² AAR at 9.

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of June, 2020, I caused to be served by electronic mail
a copy of the foregoing on the following:

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/s/ Kathleen Birch
Kathleen Birch