

SERVICE DATE – NOVEMBER 4, 2020

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 558 (Sub-No. 23)

RAILROAD COST OF CAPITAL—2019

Digest:¹ This decision denies the petition of Western Coal Traffic League to reconsider a Board decision served on August 5, 2020, which determined the cost of capital for the railroad industry in 2019.

Decided: November 3, 2020

On August 5, 2020, the Board served a decision determining that the cost of capital for the railroad industry was 9.34% for 2019. R.R. Cost of Cap.—2019 (Decision), EP 558 (Sub-No. 23) (STB served Aug. 5, 2020). In making that determination, the Board rejected an argument by the Western Coal Traffic League (WCTL) that the Board should consider operating leases as debt for purposes of the railroads' capital structure. Id. at 4-5. On August 24, 2020, WCTL sought reconsideration of the Decision, and the Association of American Railroads (AAR) filed a reply in opposition on September 14, 2020. For the reasons discussed below, WCTL's petition for reconsideration will be denied.

BACKGROUND

Each year, the Board determines the railroad industry's cost of capital, which is used in a variety of regulatory proceedings, including the annual determination of railroad revenue adequacy, rate reasonableness cases, feeder line applications, rail line abandonments, trackage rights cases, and rail merger reviews. The annual cost-of-capital figure is also used as an input in the Uniform Railroad Costing System, the Board's general purpose costing system. The Board calculates the cost of capital as the weighted average of the cost of debt and the cost of equity, with the weights determined by the capital structure (the fraction of capital from debt or equity on a market-value basis) of the railroad industry. See Methodology to be Employed in Determining the R.R. Indus.'s Cost of Cap., EP 664, slip op. at 3 (STB served Jan. 17, 2008).

In the record developed before the Decision, WCTL argued that AAR, in preparing its submission to the Board, should have treated operating leases longer than a year as debt for the purposes of the railroads' 2019 capital structure, as AAR did for finance leases (also known as capital leases). Decision, EP 558 (Sub-No. 23), slip op. at 4-5. WCTL asserted that the revision

¹ The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. See Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

to Generally Accepted Accounting Principles (GAAP) announced by the Financial Accounting Standards Board (FASB) in Accounting Standards Update (ASU) No. 2016-02² directed this result and, moreover, that operating leases look like debt liabilities on statements of financial position,³ represent financial obligations, and are calculated by applying an implied interest rate. Id. AAR declined to do so, asserting that it properly accounted for operating leases as “other liabilities on the balance sheet—liabilities that are not appropriately included in the cost-of-debt calculation.” Id. (quoting AAR Opening 9).

In the Decision, the Board determined that AAR complied with GAAP in its accounting of operating leases and explained that although ASU No. 2016-02 directs that operating leases longer than one year be recorded on balance sheets as liabilities, ASU No. 2016-02 does not, as WCTL argues, direct that operating leases be considered as debt. Id. The Board found no compelling reason to deviate from GAAP by including operating leases as debt in the capital structure because ASU No. 2016-02 does not direct the result suggested by WCTL and, moreover, 49 U.S.C. § 11161 requires that the Board conform its accounting principles to GAAP to the maximum extent practicable. Decision, EP 558 (Sub-No. 23), slip op. at 5.

In its petition for reconsideration, WCTL alleges that the Board “relied on new evidence” by referring to selected excerpts from ASU No. 2016-02 in the Decision and that, therefore, WCTL should have “an opportunity to respond to that new evidence and provide its proper context.” (WCTL Pet. 1.) WCTL argues that the Decision “involves material error in its exclusion of operating leases from the capital structure” and “overlooks the context and thus misconstrues the intended meaning of the quoted language and overall purpose of [ASU No. 2016-02].” (Id. at 1-2.) Additionally, WCTL argues, for the first time, that the Board should consider operating leases as part of the capital structure because two Class I carriers do so for purposes of determining executive compensation. (Id. at 4-5.)

In response, AAR argues that the evidence WCTL relies on, FASB’s ASU No. 2016-02, is not new, since WCTL raised it in its prior filings. (AAR Reply 1-2.) AAR also asserts that WCTL does not demonstrate material error in the Board’s Decision and, moreover, that WCTL’s claims are procedurally deficient since they constitute a request for a methodological change of the Board’s cost-of-capital calculation. (Id.)

DISCUSSION

A party may seek reconsideration of a Board decision by submitting a timely petition that (1) presents new evidence or substantially changed circumstances that would materially affect the case, or (2) demonstrates material error in the prior decision. 49 U.S.C. § 1322(c); 49 C.F.R. § 1115.3. The Board generally does not consider new issues raised for the first time on reconsideration where those issues could have and should have been presented in the earlier

² ASU No. 2016-02 was issued in 2016 and became effective for fiscal years beginning after December 15, 2018. It is available on FASB’s website at <http://www.fasb.org>, under “Standards” and “Accounting Standards Updates Issued.”

³ In this decision, the Board uses the terms “statement of financial position” and “balance sheet” interchangeably.

stages of the proceeding. Simplified Standards for Rail Rate Cases, EP 646 (Sub-No. 1), slip op. at 12-13 (STB served Mar. 19, 2008); Tex. Mun. Power Agency v. Burlington N. & Santa Fe Ry., 7 S.T.B. 803, 804 (2004). In a petition alleging material error, a party must do more than simply make a general allegation; it must substantiate its claim of material error. See Canadian Pac. Ry.—Control—Dakota, Minn. & E. R.R., FD 35081, slip op. at 4 (STB served May 7, 2009) (denying petition for reconsideration where the petitioner did not substantiate the claim of material error). Moreover, the error must be one that “would mandate a different result.” See Montezuma Grain Co. v. STB, 339 F.3d 535, 541-42 (7th Cir. 2003); Canadian Nat’l Ry.—Control—EJ&E W. Co., FD 35087 (Sub-No. 8), slip op. at 5, 9-10 (STB served Oct. 30, 2017).

As discussed below, WCTL does not present new evidence or substantially changed circumstances, and it has not shown material error in the Decision. Because WCTL has not presented any arguments on reconsideration demonstrating that the Board’s decision constituted material error, WCTL’s petition will be denied.⁴ Below, the Board discusses the standards for reconsideration as relevant to the arguments put forward by WCTL.

1. ASU No. 2016-02

“New Evidence.” WCTL first asserts that the Board relied on “new evidence” in finding that ASU No. 2016-02 does not require the classification of operating leases as debt.⁵ (WCTL Pet. 1.) To the extent that WCTL is alleging that the Board erred by considering evidence outside of the record, WCTL is incorrect. ASU No. 2016-02, a publicly available document, was referenced and discussed by the parties in their pleadings. (See WCTL Notice of Intent 1, Mar. 24, 2020; WCTL Reply 5-7, May 11, 2020; see also AAR Reply 2.) In examining WCTL’s argument that ASU No. 2016-02 directs the classification of operating leases as debt, the Board considered and discussed the relevant parts of the document in the Decision, including aspects that were not highlighted by WCTL and that undercut WCTL’s argument. WCTL’s suggestion that it was inappropriate for the Board to do so amounts to argument that the Board is not permitted to consider the parts of ASU No. 2016-02 that do not support WCTL’s position. The Board simply disagreed with WCTL’s interpretation of ASU No. 2016-02, relying on the same document WCTL referenced in its filings. For these reasons, it was not material error for the Board to consider ASU No. 2016-02.

⁴ Furthermore, the Board agrees with AAR’s general proposition that the annual Docket No. EP 558 proceeding is not the proper forum to challenge aspects of the Board’s established cost-of-capital methodology. (See AAR Reply 6.) As the Board has previously stated, those challenges are best addressed in Docket No. EP 664. See R.R. Cost of Cap.—2016, EP 558 (Sub-No. 20), slip op. at 9 & n.15 (STB served Aug. 7, 2017). Nonetheless, WCTL’s petition for reconsideration will not be considered procedurally deficient on that basis since it asks for reconsideration of the finding the Board made in the Decision in Docket No. EP 558 and was properly filed pursuant to 49 C.F.R. § 1115.3.

⁵ WCTL’s use of the term “new evidence” is unclear since, in the context of reconsideration, this term is usually applied to a situation where a petitioner provides new evidence that might warrant reconsideration of an agency decision. Here, however, WCTL does not provide any new evidence to the Board.

Paragraph BC264. WCTL also argues that the Board misconstrued the context of the quotes it cited from ASU No. 2016-02. WCTL first takes issue with the Board’s quotation of ¶ BC264, which characterizes finance lease liabilities as “the equivalent of debt” and operating lease liabilities as “not ‘debt like’ but rather, operating in nature,” in support of the statement that operating leases and finance leases are economically different transactions. (WCTL Pet. 2); Decision, EP 558 (Sub-No. 23), slip op. at 5 (citing FASB ASU: Leases (Topic 842) ¶ BC264).⁶

WCTL contends that the Board’s discussion of ¶ BC264 did not consider the context of ¶ BC263 or ¶ BC16b. (WCTL Pet. 2.) WCTL emphasizes ¶ BC263, which states that “[a]lthough all lease liabilities are measured in the same way, [FASB] concluded that separate presentation or disclosure should help a user to understand the liability balance to which the lessee’s lease costs, which differ in terms of recognition and presentation for finance and operating leases, relate.” (WCTL Pet. 2 (quoting FASB ASU: Leases (Topic 842) ¶ BC263).) Based on this excerpt, WCTL acknowledges that ASU No. 2016-02 directs that finance leases and operating leases be listed separately on the balance sheet but contends that this “is not equivalent to saying that operating leases should be excluded from the capital structure.” (WCTL Pet. 2.) WCTL then highlights ¶ BC16b, which WCTL argues “stresses the similarity of the two types of leases and the need for comparable recognition.” (WCTL Pet. 2.) This paragraph states that under prior GAAP, “[t]he existence of two very different accounting models in which the assets and liabilities associated with most leases were not recognized, but were recognized for a minority of leases, resulted in transactions that were economically similar being accounted for very differently in the statement of financial position,” which “reduced comparability for users and provided opportunities to structure transactions to achieve a particular accounting outcome.” (WCTL Pet. 2 (emphasis omitted) (quoting FASB ASU: Leases (Topic 842) ¶ BC16b).) According to WCTL, this paragraph “highlights the economic similarity of operating and finance leases” and shows that “operating leases are now no longer to be excluded in the GAAP statement of financial position, which continues to be the result under the Board’s approach.” (WCTL Pet. 2.)

AAR responds that WCTL’s interpretation is misguided. (AAR Reply 3.) AAR argues that WCTL’s citation to ¶ BC263 is unavailing since this passage “merely supports ‘a separate presentation or disclosure’ of operating leases and listing operating leases on the balance sheet fits that requirement.” (Id. at 4.) AAR likewise asserts that WCTL’s citation to ¶ BC16b does not support its position since this provision “seeks to achieve comparability for users,” which can be fulfilled by listing operating leases on the balance sheet. (Id. at 4-5.)

WCTL’s argument is unpersuasive for two reasons. First, FASB’s general statements in ¶ BC263 and ¶ BC16b indicating that finance leases and operating leases have some similarities and may be compared in certain respects does not undermine FASB’s clear and directly relevant statement that finance leases and operating leases differ in that finance leases are “the equivalent of debt,” while operating leases are “not ‘debt like.’” FASB ASU: Leases (Topic 842) ¶ BC264. The Board does not dispute that operating leases and finance leases have some economic

⁶ This paragraph, as well as the others cited in the discussion section, are available on FASB’s website at <http://www.fasb.org>, under “Standards,” “Accounting Standards Updates Issued,” and “Section C” of “Update 2016-02—Leases (Topic 842).”

similarities and, indeed, FASB states that both “types of lease liabilities are financial liabilities.” Id. However, not all liabilities constitute debt, and FASB itself says that operating leases are not “debt like.” Id. WCTL improperly conflates liabilities and debt by arguing that since ASU No. 2016-02 states that operating leases should be recognized on the balance sheet as liabilities, they must be treated as debt. Second, WCTL mischaracterizes the Decision, alleging that the Board’s findings mandate excluding operating leases from balance sheet liabilities. The Decision clearly states that, pursuant to ASU No. 2016-02, operating leases longer than a year should be recognized as liabilities on the balance sheet, and the Board found that AAR complied with this directive in its accounting of operating leases. Decision, EP 558 (Sub-No. 23), slip op. at 5.

Paragraph BC14. WCTL also argues that the Board misconstrues ¶ BC14 of ASU No. 2016-02. (WCTL Pet. 3.) In the Decision, the Board reasoned that ¶ BC14’s statement that operating lease liabilities “may not affect certain financial ratios that often are used in debt covenants” further implies that operating leases should not be treated as debt. Decision, EP 558 (Sub-No. 23), slip op. at 5 (citing FASB ASU: Leases (Topic 842) ¶ BC14). WCTL contends that the Board “ignores the larger context” of ¶ BC14, which shows that “the reason that the changed reporting may have no impact . . . is that the debt covenants already . . . treat operating leases as part of debt.” (WCTL Pet. 3.)

AAR responds that WCTL makes “faulty claims” about the context of ¶ BC14. (AAR Reply 5.) AAR argues that ¶ BC14 addresses the concern that ASU No. 2016-02 might cause debt covenants to be violated and “concludes that treating operating leases as operating liabilities ameliorates that concern.” (Id.)

WCTL misinterprets ¶ BC14, which does not state that operating leases are regarded as debt. In ¶ BC14, FASB considered whether ASU No. 2016-02 would affect entities’ access to credit or cause entities to violate debt covenants. FASB concluded that ASU No. 2016-02 would not affect entities’ access to credit because “the vast majority of users . . . presently adjust an entity’s financial statements for operating lease obligations.” FASB ASU: Leases (Topic 842) ¶ BC14. With respect to debt covenants, FASB found that any potential issues would be mitigated, in part, by the fact that “Topic 842 characterizes operating lease liabilities as operating liabilities, rather than debt” and, “[c]onsequently, those amounts may not affect certain financial ratios that often are used in debt covenants.” Id. WCTL’s contention that “the reason that the changed reporting may have no impact (‘may not affect certain financial ratios that often are used in debt covenants’) is that the debt covenants already (‘presently’) treat operating leases as part of debt,” (WCTL Pet. 3), improperly conflates the reasoning for the two separate issues FASB considered. FASB clearly states that the reason operating lease liabilities “may not affect certain financial ratios that often are used in debt covenants” is because they are characterized as operating liabilities rather than debt, not because debt covenants already treat operating leases as debt. Contrary to WCTL’s depiction, ¶ BC14 does not suggest that operating leases are, or should be, characterized as debt.

Paragraphs BC4 and BC8. WCTL highlights additional excerpts from ASU No. 2016-02 that it claims support its position that ASU No. 2016-02 requires the classification of operating leases as debt. (WCTL Pet. 3-4.) The first of these is ¶ BC4, in which FASB explains that ASU

No. 2016-02 was designed to “increase the decision usefulness and comparability among organizations by recognizing lease assets and lease liabilities on the statement of financial position and disclosing key leasing information” because “[f]or example, users of financial statements are interested in obtaining information about a lessee’s leasing activities, in general, to assess the cash flows, returns, and capital structure of the lessee and to assess the lessee’s ability to meet financial commitments.” (*Id.* at 3 (emphasis omitted) (quoting FASB ASU: Leases (Topic 842) ¶ BC4).) WCTL also references ¶ BC8, which states that “Topic 842 provides transparent and economically neutral information about the assets and liabilities that arise from leases, which is in contrast to the incomplete information provided about leases in previous GAAP that did not recognize the assets and liabilities that arise from most leases,” and declares that the update will “[i]mprove understanding and comparability of lessees’ financial commitments regardless of the manner they choose to finance the assets used in their businesses.” (*Id.* at 4 (emphasis omitted) (quoting FASB ASU: Leases (Topic 842) ¶ BC8).)⁷

The additional excerpts from ¶ BC4 and ¶ BC8 cited by WCTL do not undermine the reasoning in the Decision. Collectively, these passages indicate that FASB intended ASU No. 2016-02 to facilitate transparency as to entities’ assets and liabilities by directing entities to disclose both finance leases and operating leases on their statements of financial position; they do not, however, signify an intent that operating leases be treated as debt. They also do not overcome FASB’s clear statement characterizing operating lease liabilities as “not ‘debt like’ but rather, operating in nature.” FASB ASU: Leases (Topic 842) ¶ BC264; see also id. ¶ BC14 (“Topic 842 characterizes operating lease liabilities as operating liabilities, rather than debt.”).

2. Executive Compensation

For the first time, WCTL raises the new argument that since certain Class I carriers regard operating leases as debt when calculating their return on invested capital for executive compensation purposes, the Board should “conform to mainstream practice” and treat operating leases as debt in determining the cost of capital. (WCTL Pet. 4-5.) WCTL’s executive compensation argument is waived because WCTL could have introduced it earlier but failed to do so. See Simplified Standards, EP 646 (Sub-No. 1), slip op. at 12-13; Tex. Mun. Power Agency, 7 S.T.B. at 804. However, even if this argument had been raised earlier, it would not have been persuasive, because how individual companies treat operating leases for purposes of executive compensation is not relevant to how the Board treats operating leases for purposes of determining the cost of capital, pursuant to the Board’s statutory mandate to comply with GAAP to the maximum extent practicable. See 49 U.S.C. § 11161.

CONCLUSION

For the reasons stated above, WCTL has not shown material error in the Decision. Therefore, WCTL’s petition for reconsideration will be denied.

⁷ AAR does not specifically respond to WCTL’s claims about the meaning of ¶ BC4 and ¶ BC8 but it does assert that “none of the provisions cited by WCTL support its position or its claims of material error.” (AAR Reply 3.)

It is ordered:

1. The petition for reconsideration is denied.
2. This decision is effective on its service date.

By the Board, Board Members Begeman, Fuchs, and Oberman.