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BEFORE THE
SURFACE TRANSPORTATION BOARD

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RAILROAD REVENUE ADEQUACY	)	EP 552 (Sub-No. 22)
— 2017 DETERMINATION	)	

RAILROAD COST OF CAPITAL –	)	EP 558 (Sub-No. 21)
2017	)	

UNIFORM RAILROAD COSTING	)	EP 750
SYSTEM – 2017 CALCULATIONS	)	

REPLY COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE

WESTERN COAL TRAFFIC LEAGUE

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Dated: September 25, 2018

Its Attorneys

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RAILROAD REVENUE ADEQUACY — 2017 DETERMINATION	))	EP 552 (Sub-No. 22)
RAILROAD COST OF CAPITAL – 2017	))	EP 558 (Sub-No. 21)
UNIFORM RAILROAD COSTING SYSTEM – 2017 CALCULATIONS	))	EP 750

REPLY COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE

The Western Coal Traffic League (“WCTL”) submits its reply comments pursuant to the notice (“Notice”) that the Surface Transportation Board (“Board” or “STB”) served in the three above-captioned proceedings on July 27, 2018.

The Association of American Railroads (“AAR”) is the only other party that filed comments, and WCTL’s reply comments respond to them. The AAR’s comments are limited and ignore key matters, particularly the Board’s statutory directive to conform to generally accepted accounting principles (“GAAP”) “to the maximum extent practicable.” Little or no weight should be given to anything that the AAR might say on reply that could or should have been said in its opening comments.

While the AAR’s comments are limited, WCTL and the AAR both fully support the Board’s proposal regarding the calculation of variable costs under the Uniform Railroad Costing System (“URCS”). That aspect of the Board’s proposal should be adopted.

WCTL and the AAR also agree with the Board’s proposed adjustment to the initial cash flow inputs into the Multi-Stage Discounted Cash Flow model (“MSDCF”) because of the impact on the terminal stage. AAR Comments at 3. The underlying premise is that earnings should not be used as a proxy for cash flow when the two diverge substantially, as they do for 2017 because of the tax cut. *Id.* at 3-6. As WCTL explained in its comments, that same principle requires some corrective adjustment to the MSDCF growth rates because they, too, are tied to earnings, not cash flows.¹ Otherwise, the MSDCF should not be used at all, at least for 2017. Again, the Board’s proposal recognizes the underlying problem (as to which both WCTL and the AAR agree), but ignores its full ramifications for 2017.

WCTL and the AAR disagree regarding the Board’s proposal for revenue adequacy. The AAR’s motivation to make \$22 billion in non-cash earnings in 2017 disappear is entirely understandable, but violates the statutory directive to rely on GAAP “to the maximum extent practicable.” The AAR’s suggestions that the non-cash earnings are somehow illusory or nonrepresentative is also directly contrary to the letter Mr. Buffett wrote to Berkshire Hathaway’s stockholders earlier this year, which WCTL

¹ WCTL has explained how buybacks cause earnings per share to diverge from total cash flows and how this divergence causes the MSDCF to overestimate future cash flows and the cost of capital. The 2017 tax cut exacerbates the problem. *E.g., Buybacks Dress Up Profits*, Wall St. J., Sept. 24, 2018, at B9, <https://www.wsj.com/articles/companies-buy-earnings-gains-by-buying-back-stock-1537711201>. The article addresses how the tax cut has spurred more buybacks, *e.g.*, Union Pacific bought back 4% of its stock in the second quarter. The article notes that with buybacks, “companies can report a bigger percentage increase in per-share earnings than the profit results alone may show.” The article further confirms “while the buybacks add to per-share earnings, the effect is clear to investors and baked into the analyst earnings estimates that drive stock prices.”

quoted in its comments. Furthermore, the AAR's reliance on such additional measures as cash flow and operating revenues to present what it deems a more "useful" depiction of the industry's financial performance contradicts the AAR's and its members' previous statements in EP 722, *Railroad Revenue Adequacy*, and elsewhere that the ROI=COC test should be the exclusive measure of revenue adequacy, particularly as contrasted with the multi-factor approach recommended by WCTL.

The AAR's cited precedent, *R.R. Revenue Adequacy—1988 Determination*, 6 I.C.C.2d 933, 947-49 (1990) (AAR Comments at 3 n.5), does not support its position. As explained in WCTL's comments, that decision reasonably required the beginning and end of year deferred tax liabilities be calculated using the same tax rate. However, the railroads were required to restate the beginning of year values to reflect the new tax rate at the end of the year. Here, the AAR seeks the opposite, restating the end of year values to reflect the tax rate that will not apply for the future, contrary to the cited precedent.

Accordingly, the proposal should be adopted for URCS variable costs, adopted but expanded for cost of capital, and rejected for revenue adequacy.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of September 2018, I have caused true and accurate copies of the foregoing Reply Comments of the Western Coal Traffic League to be served upon all parties on the service lists in EP 552, 558 (Sub-No. 21), and EP 750 by first class mail, postage prepaid, or by more expeditious means.

/s/ Robert D. Rosenberg