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BEFORE THE
SURFACE TRANSPORTATION BOARD

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STB Ex Parte No. 552 (Sub-No. 22)

RAILROAD REVENUE ADEQUACY –
2017 DETERMINATION

STB Ex Parte No. 558 (Sub-No. 21)

RAILROAD COST OF
CAPITAL – 2017

STB Ex Parte No. 750

UNIFORM RAILROAD COSTING SYSTEM –
2017 CALCULATIONS

COMMENTS OF THE ASSOCIATION
OF AMERICAN RAILROADS

By decisions served on July 27, 2018 and August 10, 2018, the Surface Transportation Board (“STB” or “Board”) directed Class I railroads to submit certain supplemental data to allow the Board to complete regulatory calculations in the above-docketed proceedings. As explained by the Board, these supplemental data would be necessary to allow the Board to make one-time adjustments to the 2017 railroad industry cost of capital, revenue adequacy, and Uniform Railroad Costing System (“URCS”) proceedings to remove the distorting effects of the accounting impacts of the Tax Cuts and Jobs Act.¹ As noted in the Board’s decision, Generally

¹ Specifically, the Board directed the railroads to file figures with the accounting impacts of the deferred tax revaluations removed for Line Nos. 1 and 12 of Schedule 250; Line No. 48 of Schedule 200; and the “Net Income” and “Deferred Taxes” lines, including supporting documentation, of the cash flow

Accepted Accounting Principles require companies to recognize the effect of tax law changes in the period of enactment. As such, deferred income tax assets and liabilities as of year-end 2017 were required to be revalued using the new corporate tax rate. The revaluation resulted in a significant one-time non-cash reduction to income tax expense and, accordingly, significantly higher net income and net railway operating income for 2017.² The result is net income and net railway operating income that is two to three times higher in 2017 than in 2016.

Regarding revenue adequacy, deferred taxes and net railway operating income are included on the carriers' Schedule 250 filings and the revaluation of deferred tax liabilities during the fourth quarter of 2017 would flow through the annual revenue adequacy determination. To remove the accounting impacts of the revaluation from its 2017 URCS calculations, the Board would adjust Line No. 48, "Accumulated Deferred Income Tax Credits Balance at Close of Year," of Schedule 200 for each Class I carrier by adding back to that figure the amount of deferred taxes removed due to the revaluation.³

As for cost of capital, the Board's decision noted that "[t]he decrease in deferred tax liability and corresponding increase in net income resulting from the rail carriers' revaluation of their deferred tax liabilities would affect the Board's 2017 cost of capital determination through the Morningstar/Ibbotson multi-stage discounted cash flow (MSDCF) model. . . . Cash flows are

calculation in the Morningstar/Ibbotson multi-stage discounted cash flow model used in the cost of capital determination. The railroads, through the Association of American Railroads ("AAR"), filed the required information with supporting documents on August 16, 2018.

² Some railroads' affiliates also revalued their deferred tax liabilities to reflect the lower federal corporate tax rate, which resulted in those railroads recognizing a non-cash benefit included in Operating Expenses (All Other Equipment Accounts) and Equity in Undistributed Earnings.

³ The AAR notes that the Board's URCS proposal may implicate other schedules for some railroads, including Schedules 210, 410 and 414, though it does not appear that those additional changes would affect the outcome of any Board calculation. The railroads would be able to file adjusted versions of all the schedules impacted by the STB's proposal should the Board request that in the final decision.

an essential element in the MSDCF model, and both deferred taxes and net income factor into cash flows.” Decision at 3. The Morningstar/Ibbotson MSDCF model uses an initial cash flow and terminal cash flow as inputs.⁴ Because the initial cash flow is defined as income before extraordinary items minus capital expenditures plus depreciation plus deferred taxes, the model subtracts out the accounting of deferred taxes in 2017 by adding the large negative number for the value of deferred taxes. The value of the terminal cash flow is affected, though, because that calculation assumes that in the third stage of the model (years 11 on), depreciation equals capital expenditures, and deferred taxes are zero. Thus, in the third stage, the large negative valuation of deferred taxes is no longer subtracted out.

The Board sought comment on “whether one-time adjustments would be appropriate so that the Board’s annual determinations and calculations are more representative of the rail carriers’ financial state for 2017.” Decision at 3. Making a one-time adjustment in each of these regulatory proceedings is appropriate and consistent with the Board’s governing statute and past practice.⁵ A dramatically-increased net income value in a year when measures of revenue and cashflow are largely flat will not accurately represent the financial state of the carriers or the rail industry in 2017.⁶

As stated earlier, net income and net railway operating income for 2017 are distorted by a one-time non-cash adjustment made necessary by tax reform. Actual cash flows in 2017, as

⁴ The Board uses data from Securities and Exchange Commission for the railroads’ parent corporations SEC form 10-K in calculating the MSDCF portion of the cost of equity.

⁵ See, e.g., 49 U.S.C. § 11161 (“The Board shall periodically review its cost accounting rules and shall make such changes as are required to achieve the regulatory purposes of this part.”); 49 U.S.C. § 10101(13). See also *R.R. Revenue Adequacy—1988 Determination*, 6 I.C.C.2d 933, 947-949 (1990).

⁶ For this reason, individual rail carriers advocated to the agency that the impact of tax reform should be treated as an extraordinary item under the Board’s Uniform System of Accounts.

illustrated in Table No. 1 below, were similar to 2016. As shown in Table No. 1, net cash from continuing operations for 2017 was slightly lower than 2016 for the carriers collectively.

Table No. 1
Net Cash Provided from Continuing Operations (\$000)

RR	2017	2016
BNSF	\$7,179,846	\$7,558,735
CNGT	948,682	932,077
CPSL	413,654	404,605
CSX	2,032,348	2,891,299
KCS	591,542	445,924
NS	3,789,254	3,330,418
UP	7,685,928	7,936,306
Total	\$22,641,254	\$23,499,364

Source: 2017 Annual Report Form R-1, Schedule 240, Line 19, col. (b) & (c)

Table No. 2 presents the cash flow from investing and financing activities in addition to operating activities. It shows that like 2016, collectively the carriers had a net decrease in cash and cash equivalents – and the decrease for 2017 was even more than that for 2016.

Table No. 2
Net Increase in Cash and Cash Equivalents (\$000)

RR	2017	2016
BNSF	-\$54,258	\$5,492
CNGT	1,257	-2,452
CPSL	27,199	-59,305
CSX	-157,331	72,672
KCS	-16,291	15,728
NS	-285,469	-156,812
UP	150,835	-128,719
Total	-\$334,058	-\$253,396

Source: 2017 Annual Report Form R-1, Schedule 240, Line 37, col. (b) & (c)

Operating revenue increased slightly, as shown in Table No. 3 below.

Table No. 3
Total Railway Operating Revenues (\$000)

RR	2017	2016	Change
BNSF	\$21,124,725	\$19,661,763	7.4%
CNGT	3,185,145	2,986,580	6.6%
CPSL	1,439,472	1,314,277	9.5%
CSX	11,107,304	10,770,610	3.1%
KCS	1,349,787	1,200,135	12.5%
NS	10,551,113	9,888,266	6.7%
UP	21,239,964	19,940,431	6.5%
Total	\$69,997,510	\$65,762,062	6.4%

Source: 2017 and 2016 Annual Report Form R-1, Schedule 210, Line 13, col. (b)

In contrast, net income indicates a dramatic increase, as shown in Table No. 4.

Table No. 4
Net Income (\$000)

RR	2017	2016	Change
BNSF	\$12,104,167	\$4,259,113	184.2%
CNGT	1,636,959	320,586	410.6%
CPSL	658,454	197,433	233.5%
CSX	5,488,025	1,814,782	202.4%
KCS	664,258	156,819	323.6%
NS	5,291,341	1,692,126	212.7%
UP	10,964,838	4,761,454	130.3%
Total	\$36,808,042	\$13,202,313	178.8%

Source: 2017 and 2016 Annual Report Form R-1, Schedule 210, Line 61, col. (b)

While measures of cash flow and operating revenues on their own do not present a complete financial performance indicator for the industry, they are, however, useful for illustrating that the significantly higher reported net income for the railroad industry in 2017 does not provide any insight into whether railroads are earning enough to meet the current and future demand for rail service or provide any meaningful comparison to rail carriers' performance year

over year. As such, the Board should make the proposed one-time adjustments to remove the distorting effects of the accounting treatment of deferred taxes in 2017.

Respectfully submitted,



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September 05, 2018

CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of September, 2018, I have caused a copy of the foregoing to be served by first class mail, postage prepaid, on the following:

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