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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**DOCKET NO. EP 722
RAILROAD REVENUE ADEQUACY**

DOCKET NO. EP 664 (Sub-No. 2)

**PETITION OF THE WESTERN COAL TRAFFIC LEAGUE TO INSTITUTE A
RULEMAKING PROCEEDING TO ABOLISH THE USE OF THE MULTI-STAGE
DISCOUNTED CASH FLOW MODEL IN DETERMINING THE RAILROAD
INDUSTRY'S COST OF EQUITY CAPITAL**

**CONSUMERS UNITED FOR RAIL EQUITY
WRITTEN SUBMISSION FOR PUBLIC HEARING**



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Dated: July 21, 2015

Pursuant to the Surface Transportation Board's (STB) notice served May 8, 2015, Consumers United for Rail Equity (CURE) respectfully submits the following written statement for consideration in conjunction with the public hearing scheduled for July 22-23, 2015 in STB Docket Nos. EP 722 and EP 664 (Sub-No. 2).

CURE is a coalition of freight rail shippers. Through a growing coalition of industries and associations, CURE is working to educate the public on the impacts to consumers from railroad practices.

CURE is committed in helping to promote rail competition. To that end, CURE is particularly concerned that the promotion of effective rail competition and implementation of effective rate regulation has been impeded by the unfounded perception that the railroad industry has not achieved revenue adequacy on a long-term basis.

One of the goals of the **Staggers Rail Act of 1980** (P.L. 96-448) was to restore financial stability to the U.S. rail system. By all accounts, this goal has been achieved, as demonstrated by the industry's continued high levels of capital investment and shareholder returns including dividends, buybacks, and stock appreciation. In passing the **Staggers Act** 35 years ago, Congress recognized that when the rail industry achieved revenue adequacy, a more careful and thorough review of railroad rates would be appropriate.

CURE has long been concerned that the STB's annual determinations of the "revenue adequacy" for Class I carriers does not reflect the true health of the industry and its members. Further, CURE believes that the carriers' falsely perceived lack of adequate revenues has served to shield the railroads' exercise of their monopoly pricing power from STB scrutiny and prevented shippers from obtaining appropriate relief. For that reason, CURE continues to support elimination of the statutory requirement for the annual determinations.

As long as the annual requirement remains, however, the determinations should be accurate and reflect the true state of the industry. At a minimum, this should include use of an accurate cost of capital. Other evidence of financial health should be reviewed, and a comparison of return on net investment to the overall cost of capital should not preclude the consideration of additional evidence that shows that the industry and its members meet the other criteria specified in the statute for measuring revenue adequacy.

CURE strongly believes that there should be a meaningful revenue adequacy constraint on rates for captive shippers, especially for small shippers that otherwise do not have an effective path to rate relief. The Stand-Alone Cost test works only for the largest shippers, apparently only those with unit-train movements, and is very expensive to pursue. The Simplified Stand-Alone Cost test is also very expensive, offers reduced rate relief, and has been invoked only once. The Three-Benchmark approach offers limited rate relief, is not inexpensive by any means, may be ratcheted up by comparison to inflated rates paid by other shippers, faces considerable uncertainty, and has not attracted significant shipper interest.

For most shippers, the STB simply has not provided an effective means to prevent rate abuse. This should change, especially as the carriers have achieved revenue adequacy.

CURE strongly opposes railroad efforts to evaluate revenue adequacy on the basis of replacement costs. Replacement costing is inconsistent with the statutory definition of revenue adequacy in 49 USC 10704(a)(2) and the requirement for the STB to conform to generally accepted accounting principles to the maximum extent practicable in 49 USC 11141 and 11161. The use of net book value to review the adequacy of revenues is consistent with these provisions, whereas the use of replacement costs is not.

Net book value is the norm in rate regulation, and replacement costing is seldom, if ever, utilized, and for good reason, including the following: (1) replacement costing is inherently difficult to administer since values are likely to fluctuate; (2) brand new assets have higher productivity and lower operating costs, which would need to be offset against the higher capital costs; (3) ongoing renewal of assets eliminates the basis for including depreciation and also reduces the firm's risk profile; and (4) a substantial portion of the assets would not need to be replaced because replacement assets could be configured more efficiently and/or significant volumes would exit the system because the rates would not cover the costs.

In contrast, the use of standard, generally accepted accounting principles and the inclusion of capital expenditures within the asset base, at such time as the expenditures are actually made, gives the railroads ample incentives to maintain and expand capacity. Railroads are allowed to recover investments **WHEN** they are made. Railroad assets are long-lived, and there is no basis for allowing a railroad to recover costs in the years or the decades **BEFORE** investments are made – especially when there is no requirement or certainty that the funds will be invested, rather than used for dividends, buybacks, or executive compensation.

If replacement costs were utilized, it would be necessary to utilize real cost of capital to avoid a double count of inflation.

The replacement cost issue has been examined repeatedly, including by the Railroad Accounting Principles Board, and the use of replacement cost methodologies has always soundly been rejected. Given the financial strength of the railroads today, including publicly available information indicating that the railroad industry is revenue adequate, there is no plausible basis for the STB to adopt a replacement cost approach to evaluate revenue adequacy or limit the availability of rate relief.

Respectfully submitted,



David Sauer

President

CURE