

BEFORE THE
SURFACE TRANSPORTATION BOARD

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RAILROAD COST OF CAPITAL - 2018) EP 558 (Sub-No. 22)

**REPLY STATEMENT
OF THE WESTERN COAL TRAFFIC LEAGUE**

WESTERN COAL TRAFFIC LEAGUE

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Dated: May 13, 2019

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Pursuant to notice that the Surface Transportation Board (“STB” or “Board”) served in EP 558 (Sub-No. 22) on February 15, 2019, the Western Coal Traffic League (“WCTL”)¹ replies to the opening statement that the Association of American Railroads (“AAR” or “Railroads”) filed on April 22, 2019.

Therein, employing a methodology for determining railroad capital costs which has been repeatedly endorsed by the STB, the Railroads, for regulatory purposes, calculate their cost of 2018 capital at 12.22%. This is a highly enviable cost figure for the Railroads as their returns on their investments at 12+% comprise a major portion of their freight rates. In other words, inflated capital costs make for high freight rates.

The AAR capital cost calculation is also wrong for the many reasons which WCTL has provided over the years, all of which have been ignored or rejected by the agency. WCTL has repeatedly shown that the STB/AAR’s methodology produces

¹ WCTL is a voluntary association, whose regular membership consists entirely of shippers of coal mined west of the Mississippi River that is transported by rail. WCTL members currently ship and receive in excess of 125 million tons of coal by rail each year. WCTL’s members are: Ameren Missouri, Arizona Electric Power Cooperative, Inc., Austin Energy (City of Austin, Texas), CLECO Corporation, CPS Energy, Entergy Services, Inc., Kansas City Power & Light Company, Lower Colorado River Authority, MidAmerican Energy Company, Minnesota Power, Nebraska Public Power District, Western Fuels Association, Inc., and Wisconsin Public Service Corporation.

overstated cost of capital figures that far exceed mainstream values. The STB has consistently rejected WCTL's criticisms.

The following Table I presents a comparison of pertinent cost of capital values for 2018:

Table I Railroad Cost of Capital	
<u>Calculator</u>	<u>Cost of Capital</u>
AAR (2018)	12.22% ^{1/}
Matt Rose/BNSF	7% +/- ^{2/}
WCTL (2018)	7.83% ^{3/}
Morgan Stanley (2018) CSX	7.4% ^{4/}
Morgan Stanley (2018) KCS	7.1%
Morgan Stanley (2018) NS	7.5%
Morgan Stanley (2018) UP	7.1%
ISS-EVA (2018) CSX	6.2% ^{5/}
ISS-EVA (2018) KCS	6.2%
ISS-EVA (2018) NS	6.2%
ISS-EVA (2018) UP	6.1%
Sources: ^{1/} AAR cost is from its EP 558 (Sub-No. 22) filing. ^{2/} Matt Rose/BNSF is from his March 5, 2019 speech, as reported at https://www.commtrex.com/tony-hatch-articles/gwr-seeks-gold-in-high-valuations-rail-meetings-in-the-southwest-swars-ref/takeaways and https://www.railwayage.com/financeleasing/matt-rose-at-ref-2019-its-about-growth-not-cutting/. ^{3/} WCTL cost calculation utilizes the values from the AAR filing, but uses the CAPM COE only and substitutes the 5% market risk premium that Duff & Phelps recommended from January 1, 2018 through December 30, 2018. https://www.duffandphelps.com/-/media/assets/pdfs/publications/valuation/coc/erp-risk-free-rates-jan-2008-present.ashx?la=en. ^{4/} Morgan Stanley costs taken from Ravi Shanker, <i>2019/4Q18 Preview: Will Past be Prologue or Peril</i> (Morgan Stanley, Jan. 7. 2019), at 26. ^{5/} ISS-EVA costs taken from individual company reports dated January 4, 2019, at p. 2. EVA is EVA Dimensions LLC, acquired by Institutional Shareholder Services, Inc. on February 12, 2018. https://www.evadimensions.com/.	

As Table I makes clear, the AAR/STB 2018 capital cost calculation is an outlier and plainly wrong as underscored by the fact that BNSF's long-time Chairman/CEO has publicly proclaimed that the actual cost of railroad capital is about 7%, more than five percentage points, or 43%, less than the cost formulated by the AAR/STB for regulatory purposes and for payment by rail shippers for 2018.

CONCLUSION

As found by the Board's Rate Reform Task Force, "the financial health and competitive landscape of the railroad industry" has changed since 1980, but the Board's stance on railroad capital costs has not. While the Board has made some modifications, its approach still yields vastly overstated costs, as noted even by BNSF. The time has now come for change!

Respectfully submitted,

WESTERN COAL TRAFFIC LEAGUE

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CERTIFICATE OF SERVICE

I hereby certify that on this 13th day of May 2019, I have caused true and accurate copies of the foregoing Reply Statement of the Western Coal Traffic League to be served upon all parties on the service list in EP 558 (Sub-No. 22) by first class mail, postage prepaid, or by more expeditious means.

/s/ Robert D. Rosenberg