

SLOVER & LOFTUS

ATTORNEYS AT LAW

1224 SEVENTEENTH STREET, N. W.
WASHINGTON, D. C. 20036-3003

WILLIAM L. SLOVER
C. MICHAEL LOFTUS
JOHN H. LE SEUR
KELVIN J. DOWD
ROBERT D. ROSENBERG
CHRISTOPHER A. MILLS
FRANK J. PERGOLIZZI
ANDREW B. KOLESAR III
PETER A. PFOHL
DANIEL M. JAFFE

OF COUNSEL
DONALD G. AVERY

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TELEPHONE:
(202) 347-7170

FAX:
(202) 347-3619

WRITER'S E-MAIL:

October 10, 2006

rdr@sloverandloftus.com

BY HAND

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, N.W.
Washington, D.C. 20423-0001

217780



Re: STB Ex Parte No. 558 (Sub-No. 9),
Railroad Cost of Capital-2005

Dear Secretary Williams:

Enclosed please find an original and ten (10) copies of the Petition for Reconsideration of the Western Coal Traffic League in the above-referenced proceeding. Also enclosed is a CD containing the filing.

If there are any questions concerning this matter, please contact the undersigned.

Respectfully submitted,

Robert D. Rosenberg

Robert D. Rosenberg
An Attorney for Western
Coal Traffic League

RDR:tda
Enclosures
cc: Service List-w/encl.

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BEFORE THE
SURFACE TRANSPORTATION BOARD

217780

In the Matter of:

RAILROAD COST OF CAPITAL –
2005

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) Ex Parte No. 558 (Sub-No. 9)
)
)

**PETITION FOR RECONSIDERATION
OF THE WESTERN COAL TRAFFIC LEAGUE**

WESTERN COAL TRAFFIC LEAGUE

Of Counsel:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

William L. Slover
C. Michael Loftus
Robert D. Rosenberg
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

Dated: October 10, 2006

Its Attorneys

BEFORE THE
SURFACE TRANSPORTATION BOARD



In the Matter of:)

RAILROAD COST OF CAPITAL –)
2005)

Ex Parte No. 558 (Sub-No. 9)

**PETITION FOR RECONSIDERATION
OF THE WESTERN COAL TRAFFIC LEAGUE**

Pursuant to 49 C.F.R. § 1115.2, the Western Coal Traffic League (“WCTL” or “League”)¹ hereby petitions for reconsideration of the decision of the Surface Transportation Board (“STB” or “Board”) in STB Ex Parte No. 558 (Sub-No. 9), *Railroad Cost of Capital – 2005* (STB served Sept. 20, 2005) (the “Decision”), on the grounds that the Decision contains material error.

WCTL appreciates that the Board chose to initiate a separate proceeding by issuing an Advanced Notice of Proposed Rulemaking in STB Ex Parte No. 664, *Methodology to be Employed in Determining the Railroad Industry’s Cost of Capital* (STB served Sept. 20, 2006) (“Notice”), on the same day as the Decision. WCTL hopes that actions taken in that proceeding will eliminate distortions and error in the cost of capital calculations in the future. However, such future actions will, under the present

¹WCTL 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 presently ship and receive in excess of 140 million tons of coal by rail each year. A list of WCTL’s members is attached as Exhibit A.

circumstances, do nothing to correct the error in the cost of capital calculation for 2005 that WCTL demonstrated in its filing. The issuance of a advance notice of proposed rulemaking (which may, or may not, result in a notice of proposed rulemaking, which, in turn, may, or may not, result in any future changes) is thus an inadequate action on the Board's part.

Indeed, the Board's regular practice elsewhere when issuing decisions in the face of uncertainty or challenge as to the accuracy of the underlying calculations or methodology has been to make its decisions subject to revision based on the outcome of other proceedings or to hold its proceedings in abeyance altogether. For example, the Board established a "moratorium" while it considered changes to its merger rules, STB Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures* (STB served Mar. 31, 2000), *aff'd sub nom. Western Coal Traffic League v. STB*, 216 F.3d 1168 (D.C. Cir. 2000), and held already pending coal rate cases in abeyance while it considers changes to its standards for deciding stand-alone rate cases, STB Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* (STB served Feb. 27, 2006), *recon. denied* (STB served Apr. 14, 2006). Likewise, in an individual rate case, the Board relaxed the preclusive effect of a rate prescription under *Arizona Grocery Co. v. Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932), to permit an otherwise impermissible retroactive rate adjustment to reflect subsequent calculations, STB Docket No. 41185, *Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry.* (STB served May 12, 2003). Furthermore, the Board regularly

conditions any initial rate prescription relief in a rate case on the shipper's undertaking to refund to the carrier any amounts that might be due back as a result of the reconsideration and appeal process, despite the Board's lack of authority to revise its rate prescription retroactively. *See, e.g.,* STB Docket No. 41185, *Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry.* (STB served Aug. 21, 1997).

In light of the Board's established practice in these other contexts, it is incumbent upon the Board to explain why it is deviating from that practice here and not conditioning its determination of the 2005 industry cost of capital on the outcome in its new rulemaking proceeding. Indeed, if the Board feels that there is enough doubt or question to warrant a rulemaking as to its methodology, then there must be enough doubt or question as to the application of that methodology to the 2005 data. The Board's action in the Decision is thus inconsistent with the issuance of the Notice as well as its established practice.

The Decision also suffers from substantive error. In particular, the Decision claims (at 7) that "WCTL's main concerns relate ... to one input that it now suggests is too subjective." This statement is simply not a fair or complete characterization of the League's submission. The League showed that the data submitted by the Association of American Railroads ("AAR") yielded spurious results, even according to standards articulated by a former testifying expert for one of the AAR's own member railroads. More fundamentally, the League demonstrated that the pivotal error in the AAR's

submission (namely, using a five-year consensus earnings forecast to project growth in perpetuity), adopted by the Board in the Decision, is that it raises the cost of capital by a substantial amount just because the covered railroads are enjoying increased earnings and stock prices in the short-term. A methodology for economic regulation that allows regulated entities to charge more because they are enjoying increased earnings is inherently defective on its face, yet nowhere in its Decision does the Board even acknowledge the fundamental problem identified and demonstrated by the League.

To the extent the Board advances any response in its Decision, it is that “[t]here is a norm of regularity in government conduct that presumes an agency’s duties are best carried out by adhering to the settled rule.” Decision at 7. The League has no quarrel with the proposition that precedent should generally be followed, but the general presumption should yield when there is a clear demonstration that the practice, procedure, and/or methodology yields absurd, or at least suspect, results in a particular instance, such as allowing regulated carriers to charge more when, and just because, their earnings and stock prices increase. The Board’s Decision evinces a complete unwillingness and even refusal to consider the League’s central thesis that cannot be reconciled with the Board’s duties under the ICC Termination Act and the Administrative Procedure Act.

Remarkably, the Decision then goes on to criticize the League for not having presented evidence that the analysts forecasts have understated actual earnings growth in past years:

And although the agency has been using this IBES data since 1988, WCTL has offered no empirical evidence (as opposed to theoretical concerns) that the approach followed by the agency for the past 16 years has produced growth rate predictions that have proven to be systematically below the actual earnings growth.

Decision at 7 (footnote omitted). The Board's comment is baffling in several respects.

First, the Board faults the League for failing to provide "empirical evidence" that the growth estimates have been systematically below actual earnings growth. This comment sidesteps the League's point. Whether relatively short-term earnings estimates (*e.g.*, for five years) have matched actual performance (for the long-term, presumably) has no bearing on whether the Decision's finding that the railroad industry can, will, and should maintain growth at an expected 13% in perpetuity is sound or even remotely plausible. The League's focus was on the credibility of the 2005 data, not the data in prior periods. Even if prior cost of calculations were sound, they would not justify adoption of a figure for 2005 that appears suspect, at least not without further scrutiny (which the Decision eschews).

Second, even assuming *arguendo* that the Decision's undocumented assertion that those past projections have systematically understated actual earnings growth is correct, it begs the question of how and why the STB has continued to find railroads habitually revenue inadequate. If the analysts' forecasts accurately depicted (or understated) actual growth as posited by the Board, then railroads would logically have earned their cost of capital on at least a semi-regular basis, especially as the

incontrovertible evidence is that the railroads' financial health has improved enormously over the past twenty-plus years or even the past five. Likewise, railroad stock prices have enjoyed substantial gains in the past few years. The problem is that increased railroad earnings and profitability are used to project still greater earnings and profitability so that the railroads always need to earn more, but can never earn enough. This problem is exemplified by the 2005 data and squarely identified by the League, yet the Board's Decision does nothing to address it.

Finally, in footnote 16, the Decision noted that the growth rates used by the Board and its predecessor peaked at 14.3% in 1982. The apparent implication is that the 2005 growth rate projections are not excessive when viewed in historical context. However, inflation and interest rates were much higher in 1982, *e.g.*, the yield to maturity on 30-year Treasury notes was 12.76%,² whereas the League's filing (Crowley V.S. at 14 and Exhibit 3) demonstrated that the risk-free rate in 2005 was 4.65% based on the average 20-year Treasury note yield to maturity. Attempting to defend the 2005 analysts forecasts on the basis of the 1982 figure without noting the difference in inflation and interest rates is a nonsensical exercise.

Accordingly, the League calls upon the Board to fulfill its regulatory responsibilities and remedy the material error in its Decision by not merely initiating a

²See www.federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y30.txt

rulemaking as to possible changes for the future, but by addressing the error in the calculation in the railroad cost of capital for 2005.

Respectfully submitted,

WESTERN COAL TRAFFIC LEAGUE

Of Counsel:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

Dated: October 10, 2006

William L. Slover

C. Michael Loftus

Robert D. Rosenberg

Slover & Loftus

1224 Seventeenth Street, N.W.

Washington, D.C. 20036

(202) 347-7170

Its Attorneys

A handwritten signature in black ink, appearing to read "Robert D. Rosenberg", is written over the printed name of Robert D. Rosenberg.

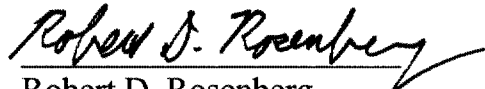
EXHIBIT A

WESTERN COAL TRAFFIC LEAGUE MEMBERS

Alliant Energy
Ameren Energy Fuels and Services
Arizona Electric Power Cooperative, Inc.
Arizona Public Service
CLECO Corporation
City of Austin, Texas
CPS Energy
Kansas City Power & Light Company
Lower Colorado River Authority
MidAmerican Energy Company
Minnesota Power
Nebraska Public Power District
Omaha Public Power District
Texas Genco, LP
Texas Municipal Power Agency
Western Farmers Electric Cooperative
Western Fuels Association, Inc.
Wisconsin Public Service Corporation
Xcel Energy

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October 2006, 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 list in this proceeding.


Robert D. Rosenberg