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ASSOCIATION OF AMERICAN RAILROADS

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BEFORE THE
SURFACE TRANSPORTATION BOARD

RAILROAD COST OF CAPITAL — 2022	STB Docket No. EP 558 (Sub-No. 26)

REBUTTAL COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS AND ITS MEMBER RAILROADS

By a decision served on February 7, 2023, the Surface Transportation Board ("STB" or "Board") instituted this proceeding to determine the railroad industry's cost of capital for the year 2022. The Association of American Railroads ("AAR") submitted the statement of the railroads on April 11, 2023. The only other interested person to submit comments was the Western Coal Traffic League ("WCTL"), which filed its reply on May 2, 2023.

Argument

The AAR reiterates that it followed the Board's instructions to use the methodology in Railroad Cost of Capital – 2021, and WCTL does not dispute that. Indeed, WCTL admits that it "does not dispute the accuracy of the AAR's mathematical calculations in implementing its interpretation of the Board's methodology."[1] There being no errors in AAR's calculations, nor any claims that the AAR failed to follow the cost-of-capital calculation methodology set forth in

[1] Reply Statement of Western Coal Traffic League ("WCTL") at 1.

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Railroad Cost of Capital – 2021, the Board should determine that the railroads' cost of capital for 2022 is 10.58 percent.

I. THE BOARD SHOULD DENY WCTL'S COLLATERAL ATTACKS, AS IT CONSISTENTLY HAS.

While it could not provide substantive concerns with the calculation, WCTL instead, as it has previously, makes several arguments in this docket that amount to nothing more than complaints about the STB's methodology for calculating the railroad cost of capital, such as data concerns and results-based issues with the measures. These complaints and concerns have been denied as procedurally deficient and have been regularly rejected by the Board in the past.[2] Indeed, several recent Board proceedings on the cost of capital specifically rejected WCTL's claims regarding the insufficiency of the MSDCF, and the desire to move to a CAPM-only approach, including several of the claims here.[3] Two years ago, the Board thoroughly explained:

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[2] *See Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital*, EP 664 (Sub-No. 2), slip op. at 1-2 (STB served Sept. 28, 2018); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2 (STB served Aug. 14, 2017); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2, 5, 9, 11-13 (STB served Apr. 28, 2017); *Pet. of the W. Coal Traffic Leag*ue, EP 664 (Sub-No. 2), slip op. at 11, 14, 17-18, 20 (STB served Oct. 31, 2016); *Use of a Multi-Stage Discounted Cash Flow Model*, EP 664 (Sub-No. 1), slip op. at 11-13 (STB served Jan. 28, 2009).

[3] *See R.R. Cost of Cap.—2021*, EP 558 (Sub-No. 25), at 3 (STB served Aug. 2, 2022); *R.R. Cost of Cap.—2020*, EP 558 (Sub-No. 24), at 3 (STB served Aug. 6, 2021); *see also Revisions to the Board's Methodology for Determining the Railroad Industry's Cost of Capital ("Revisions")*, EP 664 (Sub-No. 4), at 5 (STB served June 23, 2020).

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> The Board has explicitly rejected some, such as WCTL's requests to either move to a CAPM-only approach or to change the Morningstar/Ibbotson MSDCF regarding cashflows and growth rates, in prior decisions. WCTL's other suggestion, that Morningstar/Ibbotson MSDCF's "variability" is a reason to abandon it, has been implicitly rejected in the Board's decisions finding that Morningstar/Ibbotson MSDCF and [Capital Asset Pricing Model ("CAPM")] each have their own strengths and weaknesses that, when averaged together, lead to a more robust result.[4]

Similarly, last year, the Board rejected WCTL's methodological concerns, noting that:

> WCTL reiterates numerous critiques of the MSDCF and arguments in favor of the CAPM-only approach and its calculation of the cost of equity that have previously been rejected by the Board. See, e.g., *Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital*, EP 664 (Sub-No. 2), slip op. at 1-2 (STB served Sept. 28, 2018) (rejected WCTL's arguments against the use of the MSDCF in the agency's estimation of the railroad industry's cost of capital); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2 (STB served Aug. 14, 2017) (rejected WCTL's arguments against the use of the MSDCF in the agency's estimation of the railroad industry's cost of equity capital); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2, 5, 9, 11-13 (STB served Apr. 28, 2017) (rejected WCTL's arguments supporting a CAPM-only approach and WCTL's position that the Board must incorporate a market-risk premium of five percent or lower); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 11, 14, 17-18, 20 (STB served Oct. 31, 2016) (explained that a methodology that uses multiple models is more robust than a methodology that utilizes only one model). The annual cost of capital proceeding is not an appropriate docket for proposals to modify the Board's approach to calculating the cost of capital. The Board has previously stated that challenges to the Board's cost-of-capital methodology should be addressed in Docket No. EP 664 and not in the annual cost-of-capital proceeding. *See R.R. Cost of Cap.— 2016*, EP 558 (Sub-No. 20), slip op. at 9 & n.15 (STB served Aug. 7, 2017).
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> Furthermore, the Board has stated that the mere existence of alternative methodologies does not mean the Board's methodology is flawed. *See R.R. Cost of Cap.—2020*, EP 558 (Sub- No. 24), slip op. at 3 (STB served Aug. 6, 2021); *R.R. Cost of Cap.—2018*, EP 558 (Sub-No. 22), slip op. at 2 (STB served Aug. 6, 2019), *corrected* (STB served Sept. 30, 2019). The

4 *See Revisions*, at 5 (citations omitted).

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Board has explicitly rejected many of WCTL's alternative proposals in the past and WCTL's alternative cost-of-capital figures are not properly before the Board here in any case.[5]

As has been the case for numerous years, the Board should recognize the deficiency of WCTL's complaints about the methodology and reject WCTL's arguments.

II. THE BOARD SHOULD NOT REWARD WCTL'S FAILURE TO PROPERLY PETITION FOR RULEMAKING

In an attempt to preempt the procedural deficiency argument, however, WCTL tries to backdoor its reply as a petition for rulemaking, requesting it be construed as such "to the extent necessary to have its concerns considered and addressed."[6] The Board should not entertain this request.

WCTL is not a nascent entity with little knowledge of Board process and procedure. They are the exact opposite -- WCTL is a mature practitioner and frequent filer before the Board. Indeed, WCTL routinely files *in this very docket* the same or similar complaints about the methodology and is annually advised that this is not the docket for such challenges. WCTL cannot claim ignorance, nor should it be rewarded for not following the Board's consistent advice to file in the appropriate docket, much less its procedural rules.

WCTL has even petitioned for a similar rulemaking change in the past, yet in this proceeding does not even cite the regulations governing the Board's procedures for such a

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5 *R.R. Cost of Cap.—2021*, at 3.

6 WCTL at 4.

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petition, much less provide specificity with regard to its request.[7] Furthermore, WCTL recently filed a writ of mandamus against the Board in that very procedural docket where it previously petitioned the Board for a change to the cost of capital methodology.[8] These are not the actions of a unwitting, inexperienced party. WCTL should, therefore, follow the Board's procedures for a petition for rulemaking, not slip it into a reply in this docket in the most general terms.[9]

In WCTL's prior formal attack on the cost of capital methodology, WCTL petitioned for similar relief as they do here, namely to abolish the MSDCF, and utilize CAPM only with a MRP of 5% or lower.[10] The Board should deny WCTL's request for the same reasons rejected them on three separate occasions in the previous docket.

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[7] *See* WCTL Petition, *Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital*, EP 664 (Sub-No. 2)(Aug. 27, 2013); *see also* 49 C.F.R. § 1110.2 ("Opening of proceeding").

[8] *See* Notice of Court Action, *Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital*, EP 664 (Sub-No. 2)(STB Served May 12, 2023).

[9] It is also not entirely clear what the "text or substance" of the change WCTL is proposing the Board to adopt. 49 C.F.R. §1110.2(c). As noted, WCTL wants the rulemaking to "extent necessary" to address its concerns, and it only supplies a generalized conclusionary statement that the Board should rely exclusively on CAPM, but with an MRP not exceeding 6%, and not utilize MSDCF. WCTL at 4, 27; *see, infra,* fn 10.

[10] Here WCTL requests that "[t]here is no sound basis for continuing to use the MSDCF" so the Board "should rely exclusively on the CAPM, albeit with a MRP not exceeding 6%, to calculate the COE portion of the COC" and revise prior cost of capital values. WCTL at 27-8. The Board previously rejected such results-based approach, specifically noting, when WCTL requested a MRP of 5% or lower, that "[c]hoosing a methodology in order to produce a result below a certain level would be a form of outcome-oriented decision-making that the Board prefers to avoid." *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), at 11 (STB served Apr. 28, 2017).

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In that prior matter, the Board undertook careful consideration of the issue, requesting comments, holding a public hearing, and allowing post-hearing filings on the record.[11] The Board then thoroughly considered the facts, and "conclude[d] that the cost-of-equity component of our annual cost-of-capital estimate for the railroad industry should be calculated, as it has been since 2009, by using a simple average of the estimates produced by the CAPM model and a discounted cash flow (DCF) model. This hybrid approach allows the Board to take advantage of each respective model's strengths while simultaneously minimizing each model's weaknesses."[12] While WCTL here undertakes to point out alleged weaknesses in the MSDCF -- and even attempts to do so in WCTL's preferred model CAPM -- this sound reasoning of the Board remains. Indeed, the fact that WCTL expresses concern with CAPM as well, proves the Board's previous reasoning that "there is no single, correct way to calculate the railroad industry's cost of equity because the true cost of equity is never revealed, using an average of the CAPM and MSDCF produces a more appropriate estimate for our regulatory purposes than reliance on CAPM alone."[13]

The prior proceeding did not end with the first denial, instead WCTL petitioned for reconsideration. The Board again rejected WCTL's claims, including those regarding buybacks,

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[11] *See Pet. of the W. Coal Traffic League,* EP 664 (Sub-No. 2) (STB served Apr. 2, 2014); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2)(STB served May 8, 2015); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2)(STB served July 29, 2015).

[12] *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), at 2 (STB served Oct. 31, 2016).

[13] *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), at 2 (STB served Oct. 31, 2016); *see Use of Multi-Stage Discounted Cash Flow Model in Determining R.R. Industry's Cost of Capital,* EP 664 (Sub-No. 1), at 15 (STB served Jan. 28, 2009).

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growth rates, and selecting a specific MRP, reiterating "the Board gave meaningful consideration to WCTL's arguments and evidence. Specifically, the Board disagreed with WCTL that the Board should adopt a CAPM-only approach and adjust its existing CAPM calculation to incorporate a market-risk premium (MRP) of five percent or lower."[14] Quickly thereafter, WCTL petitioned again for reconsideration making arguments with regard to stock buybacks. The Board subsequently denied these arguments for the third time.[15]

In sum, the Board should reject WCTL's attacks on the methodology outright. Moreover, AAR opposes WCTL's procedural workaround to having to file a separate petition for rulemaking. To the extent the Board is willing to entertain such a petition, AAR requests the Board deny it for the same reasons it has before.

Conclusion

As has been the case in prior years, WCTL concedes that AAR correctly calculated the cost of capital. Therefore, the Board should determine that the railroads' cost of capital for 2022 is 10.58 percent, and deny WCTL's backdoor petition for rulemaking.

[14] *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), at 2 (STB served Apr. 28, 2017).

[15] *See Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), at 2 (STB served Aug. 14, 2017).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of May, 2023, I caused to be served by electronic mail a copy of the foregoing on the following:

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