

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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| RAILROAD COST OF<br>CAPITAL — 2021 | )<br>)<br>)<br>)<br>) | STB Docket No. EP 558 (Sub-No. 25) |
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**REBUTTAL COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS  
AND ITS MEMBER RAILROADS**

By a decision served on February 11, 2022, the Surface Transportation Board (“STB” or “Board”) instituted this proceeding to determine the railroad industry’s cost of capital for the year 2021. The Association of American Railroads (“AAR”) submitted the statement of the railroads on April 18, 2022. The only other interested person to submit comments was the Western Coal Traffic League (“WCTL”), which filed its reply on May 9, 2022.

The AAR reiterates that it followed the Board’s instructions to use the methodology followed in Railroad Cost of Capital—2020, and WCTL does not dispute that. Indeed, WCTL admits that, “WCTL’s review of the AAR’s filing and the associated workpapers does not reveal any mathematical or associated data errors (beyond those that WCTL has noted, and the Board has rejected, previously). WCTL concurs in the removal of KCS from the composite sample.”<sup>1</sup> 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 Railroad Cost of Capital—2020, the Board should determine that the railroads’ cost of capital for 2021 is 10.37 percent.

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<sup>1</sup> Reply Statement of WCTL, *R.R. Cost of Cap.—2021*, EP 558 (Sub-No. 25) at 2 (“WCTL Reply”).

WCTL makes several arguments in this docket that amount to nothing more than complaints about STB's *methodology* for calculating the railroad cost of capital. Specifically, while WCTL complained about the cost of capital decreasing last year, this year WCTL argues that the cost of capital increased from 2020, calling it "inherently implausible" and blaming it on the Board's utilization of Multi-Stage Discounted Cash Flow model ("MSDCF"). Again, WCTL brushes off important factors in making its argument, stating that "[n]otwithstanding the Covid pandemic and its impacts, including the increase in interest rates and inflation, there is no good reason" for the change.<sup>2</sup> WCTL then again faults the MSDCF's "instability, and the resulting instability in the hybrid COE and the overall COC, spring from the model's excessive sensitivity to changes in the analyst growth rates, due particularly to the absence of a transition in the second stage and the failure to adjust for stock buybacks."<sup>3</sup> WCTL further notes stock repurchases by railroads "distort" the growth rate in the model.<sup>4</sup> But these complaints are simply concerns with the Board's methodology. What WCTL fails to acknowledge, once again, is these and similar collateral attacks are inappropriate in this docket and have been regularly rejected by the Board in the past.<sup>5</sup> They should similarly be rejected here.

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<sup>2</sup> *Id.* at 3.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 11-16.

<sup>5</sup> 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 League*, 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).

As the Board has consistently explained, attacks on the underlying methodology are properly litigated through a proceeding on revising the methodology, not the annual cost of capital proceeding.<sup>6</sup> Indeed, as noted last year, the Board's most recent proceeding regarding revisions to the cost of capital methodology, specifically rejected WCTL's claims regarding the insufficiency of the MSDCF, including the claims made here about growth rates.<sup>7</sup> There the Board thoroughly explained:

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.<sup>8</sup>

As has been the case for numerous years, the Board should reject WCTL's collateral attacks on its methodology in this proceeding.

Also, WCTL again makes a results-based argument that the cost of capital should be lower than what was calculated for 2021. In an attempt to show that the 2021 result is not low enough, WCTL suggests the Board look to multiple alternative calculations that it has suggested

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<sup>6</sup> See *Methodology to be Employed in Determining the Railroad Industry's Cost of Capital*, EP 664, at 18 (STB served Jan. 17, 2008) (explaining the Board maintains "one (Docket No. EP 558 sub-numbered proceedings) for the annual estimate and another (Docket No. EP 664 sub-numbered proceedings) for petitioners to advocate changes to the cost-of-capital model)... While in the past we have entertained challenges to the agency's model in the 558 proceedings, we will no longer do so.").

<sup>7</sup> See *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).

<sup>8</sup> *Revisions* at 5 (emphasis added) (citations omitted).

in the past.<sup>9</sup> The Board did not entertain these arguments in last year's cost of capital proceeding, stating:

The Board has previously stated that the mere existence of alternative methodologies does not mean the Board's methodology is flawed. *See 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). Moreover, the Board has also 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). Therefore, because WCTL's alternative cost-of-capital figures *are not properly before the Board*, the Board will review AAR's submission under the Board's established methodology for calculating the railroad industry's cost of capital.<sup>10</sup>

AAR agrees with the Board that WCTL's arguments this year are not properly before the Board, and requests the Board, again, reject WCTL's arguments this year.

Just like last year, WCTL also takes aim at the statement that the 2021 beta "is the lowest since 2009...this is the thirteenth consecutive year that the railroad beta has been above 1.0, further demonstrating that railroad stocks are consistently more volatile and are regarded as having more risk than does the market generally."<sup>11</sup> Repeating similar arguments to last year, WCTL claims that it is an oversimplification and selectively cites sources it believes show the railroad beta should be lower. As AAR explained in last year's rebuttal, the beta is the coefficient of systematic, non-diversifiable risk, so it seeks to estimate the measure of non-diversifiable risk of the railroads, as compared to the market as a whole.<sup>12</sup> Because the Board has not taken action to change the methodology since last year, Mr. Gray again used the 5-year

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<sup>9</sup> See WCTL Reply at 6-10.

<sup>10</sup> *Cost of Capital—2020*, at 3 (emphasis added).

<sup>11</sup> AAR Opening, V.S. Gray at 37; see WCTL Reply at 9-11.

<sup>12</sup> See AAR Rebuttal, *Cost of Capital—2020*, at 6-7.

rolling average to calculate beta. While AAR and WCTL again have conflicting views regarding beta trends, the Board should again recognize that “[t]he parties’ conflicting interpretations of trends in beta are not material to an assessment of whether beta was calculated correctly for [the year].”<sup>13</sup>

In sum, the Board’s process for calculating the cost of capital has been sufficient in prior years, and WCTL has provided no justification to change the process now, much less in this docket. The Board should reject WCTL’s attacks on the methodology outright.

### **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 2021 is 10.37 percent.

Respectfully submitted,



Kathryn D. Kirmayer  
J. Frederick Miller Jr. (*admitted in MD*)  
Association of American Railroads  
425 Third Street, S.W., Suite 1000  
Washington, DC 20024

May 31, 2022

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<sup>13</sup> *Cost of Capital—2020*, at 9.

## CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of May, 2022, I caused to be served by electronic mail a copy of the foregoing on the following:

Robert D. Rosenberg  
Slover & Loftus  
1224 Seventeenth St., NW  
Washington, DC 20036-3003  
[rdr@sloverandloftus.com](mailto:rdr@sloverandloftus.com)

/s/ Kathleen Birch  
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Kathleen Birch