

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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RAILROAD COST OF
CAPITAL — 2019

STB Docket No. EP 558 (Sub-No. 23)

**REPLY TO PETITION FOR RECONSIDERATION OF THE ASSOCIATION OF
AMERICAN RAILROADS AND ITS MEMBER RAILROADS**

Pursuant to 49 C.F.R. § 1115.3(d), the Association of American Railroads (“AAR”) hereby replies to the Petition for Reconsideration (“Petition”) filed by the Western Coal Traffic League (“WCTL”). For the reasons stated herein, the Petition should be denied.

By a decision served on February 27, 2020, the Surface Transportation Board (“STB” or “Board”) instituted this proceeding to determine the railroad industry’s cost of capital for the year 2019. AAR submitted the statement of the railroads on April 20, 2020. The only other interested party to submit comments was the Western Coal Traffic League (“WCTL”), which filed its reply on May 11, 2020, arguing, among other things, that the AAR should count operating leases as debt, even though GAAP does not require such treatment. On August 5, 2020, the Board issued a decision finding the cost of capital for the railroad industry was 9.34% for 2019, and finding “no compelling reason ... to deviate from GAAP as WCTL suggests.” *Railroad Cost of Capital – 2019*, EP 558 (Sub-No. 23) at 5 (STB served Aug. 5, 2020). On August 24, 2020, WCTL filed a petition for reconsideration arguing material error and contending that the Board’s decision relied upon new evidence. Petition at 1.

Generally, a party may seek reconsideration of a Board decision by submitting a timely petition that (1) presents new evidence or substantially changed circumstances that would

materially affect the case, or (2) demonstrates material error in the prior decision. *See* 49 U.S.C. § 1322(c); 49 C.F.R. § 1115.3. WCTL has failed to identify any new evidence, nor has WCTL demonstrated any material error in the Board’s decision. Even so, the claims of WCTL amount to a request to change the methodology for the Board’s calculation of cost of capital, which is procedurally deficient. Therefore, WCTL’s petition for reconsideration should be denied.

I. WCTL Fails to Identify Any New Evidence

WCTL claims “the Board’s Decision relied on new evidence, and it is appropriate that WCTL have an opportunity to respond to that new evidence and provide its proper context.” Petition at 1. WCTL claims the new evidence relied on by the Board is “two selected portions of ‘Section C’ of [Financial Accounting Standards Board (FASB)]’s Update to ASU No. 2016-02.” Petition at 1. However, provisions of this document can hardly be considered new evidence when it was WCTL that brought the document to the Board’s attention in its prior filings.¹ The document WCTL referred to previously, FASB ASU 2016-02, is comprised of three sections: (1) Section A—Leases: Amendments to the FASB Accounting Standards Codification; (2) Section B—Conforming Amendments Related to Leases: Amendments to the FASB Accounting Standards Codification; and (3) Section C—Background Information and Basis for Conclusions.² In its decision, the Board properly cited several provisions of Section C that

¹ *See* Reply Comments of WCTL, EP-558 (Sub-No. 23), at 5 (“FASB ASU 2016-02, a part of GAAP that took effect no later than reporting year 2019, requires companies to list operating leases of more than a year as liabilities on their balance sheets, whereas they were previously generally treated as off balance sheet items.”); Letter from Robert D. Rosenberg, Attorney for WCTL, to Cynthia T. Brown, Chief, Section of Administration, Office of Proceedings, STB, at 1 (Mar. 24, 2020) (“As WCTL has previously noted, most recently on January 15, 2020, in EP 664 (Sub-No. 4), a GAAP revision, ASU 2016-02, which took effect no later than reporting year 2019, directs that operating leases longer than a year be treated as balance sheet debt.”).

² *See* Financial Accounting Standards Board, Accounting Standards Updates Issued, found at <https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498> (last visited Sept. 14, 2020) (“Topic 842”).

support the Board’s finding that operating leases should not be treated as debt. *See Cost of Capital* at 5. It is illogical for WCTL to claim that the very document it used to support its own arguments is “new evidence” when the Board uses the document to deny WCTL’s claims. It is apparent that WCTL was aware of Section C of FASB’s Update to ASU No. 2016-02 when it filed its Notice and Reply Comments. The document is not new evidence.

II. The Board Did Not Commit Material Error When It Properly Applied Generally Acceptable Accounting Procedures

WCTL also claims the Board committed material error by overlooking the context of Section C and misconstruing its meaning. A party alleging material error must do more than simply make a general allegation; it must substantiate its claim of material error. *See Can. Pac. Ry.—Control—Dakota, Minn. & E. R.R.*, FD 35081, slip op. at 4 (STB served May 7, 2009). Nothing in WCTL’s petition, however, rises to the level of a material error by the Board. In denying WCTL’s claims, the Board stated “[it] has reviewed ASU No. 2016-02, which states that operating leases longer than a year should be recognized as liabilities on the balance sheet, rather than debt, and finds that AAR complied with GAAP in its accounting of operating leases.” *Cost of Capital – 2019*, at 5. WCTL argues the Board should have interpreted provisions of Section C in a manner that favors WCTL. However, none of the provisions cited by WCTL support its position or its claims of material error.

WCTL’s interpretation of Topic 842, Section A, as a requirement to treat operating leases as debt is misguided. Topic 842 explains that the main difference from previous GAAP is the difference in treatment of operating leases, but states “[FASB] decided that ... lessees should be required to *recognize the assets and liabilities arising from leases on the balance sheet.*” Topic 842, Section A, at 2 (emphasis added). Topic 842 goes on to note that “[f]or operating leases, a lessee is required to ... [r]ecognize a right-of-use asset and a lease liability ... in the statement of

financial position[; r]ecognize a single lease cost ...[; and c]lassify all cash payments within operating activities in the statement of cash flows.” Topic 842, Section A, at 3-4. Nowhere in Topic 842 is a lessee required to count operating leases as debt, instead operating leases must be recognized and listed on the balance sheet. The Board properly interpreted these GAAP requirements, when it found “[g]iven the clarity of FASB’s position on operating leases and debt issues, and in light of the directive that the Board conform its accounting principles to GAAP to the maximum extent practicable, *see* 49 U.S.C. § 11161, the Board finds no compelling reason, on the basis of this record, to deviate from GAAP as WCTL suggests.” *Cost of Capital – 2019*, at 5. Nothing in WCTL’s petition changes the Board’s finding.

WCTL’s citation to ¶ BC263, in unavailing. WCTL concludes that “operating leases differ from finance leases and should be listed separately on the balance sheet is not equivalent to saying that operating leases should be excluded from the capital structure.” Petition at 2. Contrary to WCTL’s implications, ¶ BC263 does not support operating leases being included as debt. Instead, ¶ BC263 merely supports “a separate presentation or disclosure” of operating leases and listing operating leases on the balance sheet fits that requirement. Topic 842, Section C, at ¶ BC236.

WCTL further argues that ¶ BC16b “highlights the economic similarity of operating and finance leases and recognizes the need to change GAAP to facilitate comparability and curtail gaming The Update thus stresses the similarity of the two types of leases and the need for comparable recognition.” Petition at 2. Listing operating leases on the balance sheet, as Topic 842 requires, does not mean they are excluded from the GAAP statement of financial position. Indeed, it means just the opposite. WCTL admits that the two types of leases, operating and capital, have differences, which is why operating leases are not listed as debt, but that does not

mean they are excluded from the statement of financial position.³ Further, ¶ BC16c seeks to achieve comparability for users. Listing operating leases on the balance sheet provides that comparability.

WCTL claims the Board failed to properly interpret ¶ BC14c, because it did not account for the broader context of ¶ BC14. This argument is misguided. WCTL states “the reason that the changed reporting may have no impact (‘may not affect certain financial ratios that often are used in debt covenants’) is that the debt covenants already (‘presently’) treat operating leases as part of debt. FASB is simply updating GAAP to conform to existing practice, which is to treat operating leases as debt.” Petition, at 3 (citing Topic 842, Section C, at ¶ BC14). WCTL’s faulty claims about the context of ¶ BC14, however, do not change the meaning of Topic 842 and Section C, which states: “Topic 842 characterizes *operating lease liabilities as operating liabilities, rather than debt*. Consequently, those amounts may not affect certain financial ratios that often are used in debt covenants.” Topic 842, Section C, at ¶ BC14c (emphasis added). The concern addressed by ¶ BC14 is that the change to Topic 842 might cause a violation of debt covenants. FASB concludes that treating operating leases as operating liabilities ameliorates that concern. FASB is not requiring treatment of operating leases as debt.⁴

WCTL also claims that operating leases should be treated as debt because two Class I railroads “treat operating leases as part of invested capital for purposes of determining long-term

³ Petition, at 2 (“*The two types of leases have differences*, but operating leases are now no longer be excluded in the GAAP statement of financial position, which continues to be the result under the Board’s approach.”) (emphasis added).

⁴ While it is true FASB changed the reporting to allow for comparisons by users (e.g., Petition at 4), FASB did so by listing operating leases on the balance sheet, not as debt. Just like other operating liabilities that are not accounted for as debt but listed on the balance sheet (e.g., deferred income taxes and net pension benefit obligations), operating leases being listed on the balance sheet serves the purpose of allowing comparisons regardless of how entities choose to finance their assets.

compensation for their top executives.” Petition at 4-5. How two of the seven Class I railroads decide to calculate executive compensation is immaterial to the regulatory annual calculation of cost-of-capital. This does not change the requirements of GAAP, nor are compensation calculations by two of seven Class I railroads a compelling reason for the Board to deviate from GAAP. In short, nothing in WCTL’s arguments require the Board to reconsider its findings.

III. WCTL’S Petition is Procedurally Deficient

Finally, WCTL’s arguments amount to a request to change in the Board’s cost-of-capital methodology and, as such, is procedurally deficient. The Board has consistently held that proposed methodological changes in the annual cost-of-capital calculation should not be allowed. *Methodology to be Employed in Determining the Railroad Industry’s Cost of Capital*, EP 664, slip op. at 18 (STB served Jan. 17, 2008). As the Board explained previously, it 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).” *Methodology* at 18. As the instant proceeding is the former docket, it is not the appropriate venue for WCTL’s argument.⁵

⁵ The Board recently declined to address WCTL’s arguments regarding operating leases being treated as debt for the purposes of the cost of capital calculation in its most recent decision regarding the cost of capital method. *Revisions to the Board’s Methodology for Determining the Railroad Industry’s Cost of Capital*, EP-664 (Sub-No. 4), at 5 (STB served June 23, 2020).

CONCLUSION

AAR requests that WCTL's Petition for Reconsideration be denied, and the Board reaffirm its decision in *Cost of Capital – 2019*.

Respectfully submitted,

A handwritten signature in blue ink, appearing to be 'JD' or similar, with a stylized, cursive style.

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