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BEFORE THE

SURFACE TRANSPORTATION BOARD

STB Docket No. EP 664 (Sub-No. 2)

USE OF A MULTI-STAGE DISCOUNTED CASH FLOW MODEL IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL

OPENING COMMENTS OF ALLIANCE FOR RAIL COMPETITION

Alliance for Rail competition ("ARC") files these comments for two reasons. The first is to express support for replacement of the Board's current hybrid approach to cost of capital determinations for Class I railroads with the more accurate Capital Asset Pricing Model (CAPM) approach. The Board's use since 2009 of a hybrid approach combining CAPM with a multi-stage discounted cash flow (MSDCF) approach has led to erroneous results that consistently favor the major railroads. Consistent error is still error, and errors that consistently favor market dominant railroads are even more objectionable.

Given the active involvement of ARC and its consultants in three other pending proceedings[1], ARC relies on and generally supports the more detailed and technical analysis of the issues presented that is being filed in the opening comments in this proceeding of Western Coal Traffic League.

The second reason for ARC's decision to file these comments is that the Board has not resolved the issue of how to treat BNSF data in making its cost of capital calculations, and the lack of a resolution of this issue should not continue indefinitely. In its decision served October 3, 2011 in Docket No. EP 558 (Sub-No.14), Railroad Cost of Capital – 2010, at pages 7-8, the Board declined to include BNSF in the composite group and also held that any:

> future requests to change the assumptions that form the elements of our CAPM model must be brought (in the form of a petition for rulemaking) in a 664 proceeding.

This is a "664 proceeding", and ARC believes the issue is important. This is a separate issue from the issue raised by WCTL, and the issue of whether to replace the hybrid approach with a CAPM approach is likely to be the main, if not the only, focus of most parties' comments in this proceeding. Accordingly, ARC does

[1] EP 665 (Sub-No. 1), Rail Transportation of Grain, Rate Regulation Review; EP 722, Railroad Revenue Adequacy; and EP 724, United States Rail Service Issues

not suggest that resolution of the BNSF issue should hold up a decision on whether to use CAPM instead of a hybrid analysis.

However, the Board is also considering the implications of revenue adequacy in parallel proceedings in EP 722, and the major railroads' cost of capital is a component of revenue adequacy. We also note that the 2012 RSAM level for BNSF is 177%. See the decision served April 21, 2014 in Docket EP 689 (Sub-No. 5), Simplified Standards for Rail Rate Cases – 2012 RSAM and R/VC180 Calculations. See also the decision served September 2, 2014 in Docket EP 552 (Sub-No. 18), Railroad Revenue Adequacy – 2013 Determination, in which BNSF was found revenue adequate (along with four other railroads) in 2013.

There are various ways of dealing with the BNSF issue, including some form of extrapolation from UP data, or creation of a separate cost of capital for BNSF, or BNSF and Berkshire Hathaway, its corporate parent. ARC submits that the Board should deal with this issue sooner rather than later, as it considers regulatory changes associated with major railroads achieving (or exceeding) long-term revenue adequacy.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 5th day of September, 2014, caused copies of this document to be served on all parties of record by first class mail or by electronic means.

Terry Whiteside