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BEFORE THE
SURFACE TRANSPORTATION BOARD

In the Matter of:	)	
	)	
SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE INVESTMENT	)	STB Ex Parte No. 680 (Sub-No. 1)
	)	

OPENING COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE

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Dated: May 8, 2009

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The Western Coal Traffic League ("WCTL" or "League")[1] hereby submits the following opening comments in response to the Notice ("Notice") that the Surface Transportation Board ("STB" or "Board") served in the above-captioned proceeding on April 8, 2009, relating to the *Supplemental Report to the U.S. Surface Transportation Board on Capacity and Infrastructure Investment* ("*Supplemental Report*") prepared by Laurits R. Christensen Associates ("Christensen Associates") and released on April 8, 2009.

For some time now, the Association of American Railroads ("AAR"), its member railroads, and associated allies have been attempting to disseminate a narrative to

[1]WCTL 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 175 million tons of coal by rail each year. WCTL's members are: Ameren Energy Fuels and Services, Arizona Electric Power Cooperative, Inc., CLECO Corporation, Austin Energy (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 Municipal Power Agency, Western Farmers Electric Cooperative, Western Fuels Association, Inc., Wisconsin Public Service Corporation, and Xcel Energy.

the effect that despite the enormous success achieved by the railroad industry since enactment of the Staggers Rail Act of 1980, it is still necessary to forebear from any sort of meaningful regulation or oversight of the railroad industry. The older version of this narrative relied on such themes as: (a) the industry's economic gains are temporary and/or may prove illusory, (b) the railroads are, at any time, only a moment away from financial disaster, and (c) the railroads and/or their investors will refuse to provide the capital that the railroads require in order to continue functioning if there is even a hint of a threat of meaningful regulation and oversight, *etc.* The narrative has more recently evolved to recognize that the gains are now established and enduring, and the railroads are now generating excess capital for their investors rather than needing to attract additional capital from investors, but to insist that regulation and oversight, as well as measures that would facilitate meaningful intramodal competition, must nonetheless still be avoided because: (a) the railroads have exhausted their excess capacity; (b) they must be allowed to generate sufficient earnings to justify the further investment that is required so that the railroads can continue to grow; and (c) the growth is required not merely to serve customer needs, but also to provide public benefits such as taking trucks off the road, thereby relieving highway congestion and increasing fuel efficiency, *etc.*

The *Supplemental Report* performs a useful function in debunking central elements of the railroads' narrative. The analysis confirms that, for the most part, the railroads continue to have substantial excess capacity. In the few instances where they may not, the shortage relates not so much to track capacity as it does to problems with terminals or a failure to deploy resources or manage them effectively. Thus, the analysis performed in the Cambridge Systematics study much touted by the AAR does little to address the real capacity issues, such as they are.

The *Supplemental Report* also casts substantial doubt on the railroads' traffic projections and their associated revenue needs. In particular, the report shows that coal growth is unlikely to reach the levels assumed by Cambridge Systematics and the Freight Analysis Framework. The likelihood that there will be considerably less overall traffic growth than has been depicted by the AAR (at least for these purposes) substantially undermines the railroads' claimed need for additional revenues and investment. Moreover, the substantial lead time required for new coal-fired power plants means that the railroads should have no difficulty anticipating the growth in coal traffic that does emerge. The relative stability and predictability of the volume of coal traffic, especially compared to other commodities, means that the railroads should be able to plan to service that growth in a reliable and efficient manner, something that the railroads have failed to do in the past. Ironically, the railroads have used that failure as a pretext for raising rates, when the real problem is their own mismanagement and/or their determination that they are better off if they are unable to meet customer needs, especially compared to anything approaching excess capacity (which they continue to enjoy, despite their protestations to the contrary).

The *Supplemental Report* notes the possibility that intermodal traffic growth could be greater than projected, but such possibilities seem particularly speculative in light of current economic conditions. Beyond that, intermodal traffic is generally, as the *Supplemental Report* acknowledges to some extent, subject to competitive factors to a far greater extent than coal and intermodal shippers do not generally face the captivity problems that are common to coal shippers, even those that are nominally served by more than one carrier. Indeed, coal shippers such as WCTL's members and other captive shippers continue to have substantial concerns that they are effectively being forced to subsidize the railroads' focus on growing their intermodal traffic, even though that traffic appears to be of limited or negative profitability. That concern is certainly reinforced by the current economic downturn.

The *Supplemental Report* also suggests that the Cambridge Systematics report has given insufficient weight, or at least attention, to the role that productivity improvements can and will play in servicing the growth in traffic. The *Supplemental Report* shows that productivity growth, even at a modest 0.5% per year, will cover a significant portion of the railroads' supposed needs to expand capacity. If productivity growth were on the magnitude of the levels of recent RCAF productivity growth (in excess of 1.0% per year), then the contribution would be over twice as large. Productivity would also cover a substantially larger amount of the railroads' expansion needs if growth were of the more moderate level noted by the *Supplemental Report.* The *Supplemental Report* also notes that the Cambridge Systematics report does not appear to have given any weight to the capacity gains associated with positive train control, even though those improvements are expected to be very significant, especially over the most congested lines that are the ostensible focus of the Cambridge Systematics report.

WCTL further notes that the *Supplemental Report* accepts, without reservation, the Cambridge Systematics report's use of a highway-based measure of capacity adequacy, *i.e.*, the assessment is based on the day of the year with the projected 85th-highest percentile of traffic. However, if 40% of the traffic is coal (*Supplemental Report* at _), and coal has a low traffic priority (confirmed by the service received by WCTL members over the years and by railroad management), then the question arises whether such congestion can be adequately addressed by having the railroads focus on other traffic during periods where there is a "crunch," as the railroads most certainly do anyway.

As overstated as the Cambridge Systematics' traffic projections are, they pale in comparison to the growth assumptions embodied in the multi-stage discounted cash flow ("MSDCF") portion of the AAR's April 20, 2009 filing in STB Docket No. 558 (Sub-No. 12), *Railroad Cost of Capital -- 2008*. The AAR's MSDCF calculations use a methodology proposed by the AAR and that the STB adopted over WCTL's strong objections that the underlying assumptions were not at all realistic.

The AAR's submission posits that the railroad industry's earnings will growt at an average compound rate of 10.05% per year for the next ten years. Since that figure represents nominal growth, it is appropriate to use some adjustment for inflation to determine the real rate of growth for comparison to growth in traffic volumes.. The AAR's MSDCF calculations use a long-term inflation rate of 0.6%. In the interests of conservatism, WCTL will round that figure up to 1%, which nearly doubles it. Attributing 1% of the growth to inflation leaves a real growth rate of approximately 9.4% (1.105 = 1.01 x 1.0940594). A 9.4% growth rate causes the railroads' real earnings to double within eight years ($1.094^8 > 2.05$). The 9.4% growth rate is more than double the

4.3% real growth rate that the AAR calculates for the economy as a whole, and a doubling of projected earnings within eight years is a remarkable rate of increase, especially for mature industry like the railroads.

In contrast, the rate of traffic increase posited in the Cambridge Systematics report/Freight Analysis Framework forecast is substantially less, notwithstanding the strong demonstration in the *Supplemental Report* that the rate of increase is likely to be substantially overstated. The Cambridge Systematics report posits that railroad freight tons will grow from 1.768 billion in 2002 to 3.292 billion in 2035 (*Supplemental Report* at 5-3, Table 5-1). This increase amounts to 86% (3.292/1.768 = 1.862) over a period of 33 years, corresponding to a growth rate of 1.9% ($1.019^{33} = 1.861$).[2] In other words, the total growth in railroad earnings over just the next eight years is projected to exceed the total growth in railroad volume over the 33 years between 2002 and 2035.

The implication is that railroad earnings will grow almost five times faster than volumes, at least for the next eight years.[3] The portion of the earnings growth not attributable to increasing volume can only be attributable to productivity gains or price increases. Since productivity gains are expected to be modest, the only plausible

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[2]The projected rate of growth in rail freight tonnage between 2010 (2.083 billion tons) and 2020 (2.445 billion tons) is actually less, 1.615% (2.083 billion x 1.01615^{10} = 2.445 billion).

[3]WCTL recognizes that the economy is in flux and that a possibility exists that there will be a quick recovery, which could translate into a sharp growth in traffic. That said, it seems unlikely that traffic levels would exceed those depicted in the Cambridge Systematics report, which was prepared before the economic downturn. Additionally, the projected 10.05% growth rate in earnings per share actually represents a considerable decrease from earlier (pre-downturn) levels.

explanations are that: (a) the ten-year forecast of growth in earnings per share embodied in the MSDCF calculations is completely unrealistic, or (b) the MSDCF calculations posit massive real rate increases, that is, rate increases will cause post-inflation, post-productivity increases in railroad earnings to exceed 8% per year over the next ten years.

WCTL's own view is that the AAR's MSDCF calculations lack credibility and that the Board should not rely upon them at this time to calculate the railroad industry cost of equity. However, regardless of how the Board calculates the railroad's cost of capital, massive increases in earnings (and/or cash flow) of this magnitude should be much more than sufficient to fund whatever railroad expansion may be needed. Consequently, speculation as to the need for the railroads to expand their capacity does not provide a meaningful basis for regulatory forbearance.

Respectfully submitted,

WESTERN COAL TRAFFIC LEAGUE

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