BEFORE THE
SURFACE TRANSPORTATION BOARD
Washington, DC 20423

In the Matter of:	)	
METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL	)	**STB Ex Parte No. 664**

COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION

Arkansas Electric Cooperative Corporation ("AECC") respectfully submits these Comments in response to the Notice of Proposed Rulemaking in which the Board proposes to revise its method for calculating the railroad industry's cost of capital.[1]

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serve approximately 460,000 customers located in each of the 75 counties in Arkansas. In order to serve its member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. The largest of AECC's generation assets are its ownership interests in the White Bluff plant at Redfield, Arkansas and the Independence plant

[1] 72 Fed. Reg. 45493 (Aug. 14, 2007), corrected Decision released Aug. 20, 2007.

at Newark, Arkansas, each of which typically burns in excess of 6 million tons of Powder River Basin (PRB) coal annually. AECC holds a 35 percent interest in each of these plants (for which Entergy is the operator and majority owner). In addition, AECC holds a 50 percent interest (with AEP) in the Flint Creek plant, which is located in Gentry, Arkansas. This plant normally burns in excess of 2 million tons of PRB coal annually. As a result of the need to utilize rail transportation for these high-volume, long-distance coal movements, AECC has a direct interest in matters that relate to the financial health of the rail industry, and has been an active participant in numerous rail-related proceedings before the Board.

AECC applauds the Board for recognizing and responding to the changes of circumstance that now support use of the capital asset pricing model ("CAPM") method in place of the discounted cash flow ("DCF") method historically used by the Board (and ICC) to calculate the cost of equity component of the railroad cost of capital. AECC defers to the Western Coal Traffic League (WCTL) and other parties to address detailed technical issues regarding CAPM and its implementation. However, to assist the Board in its consideration of implementation issues that may arise, AECC would like to highlight the following general considerations:

- As discussed in footnote 15 of the Board's notice, the plan to utilize "merger-adjusted" data may encounter practical difficulties. For example, the current proposal of Canadian Pacific Railway (CP) to acquire the Dakota, Minnesota and Eastern Railroad (DME) illustrates the general situation where a Class I railroad may acquire a smaller railroad that is not publicly traded (i.e., so no pre-merger stock data would be available) and not subject to Class I reporting requirements. Similarly, in a situation like the Conrail transaction, there may be pre-merger stock data, but the form of the acquisition may raise issues regarding the allocation of pre-merger returns among different acquiring carriers.

- Care may need to be exercised in the interpretation of stock price data for U.S. carriers that subsume foreign operations, whether integrated (as with KCS and the former TFM) or otherwise. Likewise, stock price data for some U.S. carriers encompass the results achieved by non-rail affiliates (such as Norfolk Southern's Pocohontas Land Corp.). The cost of capital for U.S. rail carriers should not include a premium for any extraordinary risks that may be associated with activities undertaken by corporate affiliates.

- The Board's proposed computation of carrier-specific "betas" from railroad stock returns may be affected by considerations other than financial risk that do not arise in most other sectors. In the duopolistic operating environment that has evolved for the Class I railroads, anything that has the effect of restricting competition may increase a carrier's stock performance relative to the market, and create the artificial appearance of a "risk premium" under the contemplated methodology. Theoretical concerns regarding the risk of collusive conduct in a duopoly are well-documented, and many shippers have real-life concerns that such conduct can be observed in the carriers' public pricing initiatives. Under these circumstances, the Board must be vigilant about safeguarding competition in order to ensure that the proposed methodology produces valid results, and does not amplify whatever incentives may exist for collusive conduct. In this light, it can be seen that the highly concentrated nature of the rail industry raises complications for the contemplated firm-specific computations.

- The Board's alternative proposal to treat all betas as 1.0 would address the concerns cited above regarding carrier-specific computations. However, they would raise a separate set of issues regarding validity. While the average beta of a randomly selected firm may tend towards the 1.0 value, it is not obvious that the average beta for firms in a given industry should tend towards that same value. Railroads might cite the capital intensiveness of their industry as a systematic source of atypically high risk, while shippers might point to the Board's authority to modulate the exercise of rail market power as a consideration that minimizes the need for a risk premium. Instead of assuming a uniform value of 1.0, the Board may wish to determine a beta value that may differ from 1.0, but accurately reflects an average for the rail industry.

Overall, AECC urges the Board to maintain its focus on the importance of accurate cost of capital determinations for use in regulatory proceedings, and not to be influenced by investment firms who would have the Board distort its regulatory framework to artificially inflate the railroads' ability to extract higher rates from their customers. The guiding principles underlying the new methodology must be reflective of the Rail Transportation Policy, particularly those elements set forth in 49 U.S.C. §10101 (2) (require fair regulatory decisions), (5) (foster sound economic conditions in transportation), (6) (maintain reasonable rates where there is an absence of effective competition), (12) (prohibit predatory pricing), and (13) (ensure the availability of accurate cost information in regulatory proceedings).

Respectfully submitted,

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