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SERVICE DATE – MAY 16, 2007

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 558 (Sub-No. 10)

RAILROAD COST OF CAPITAL – 2006

Decided: May 14, 2007

By this decision, we are instituting a proceeding to determine the railroad industry's cost of capital for 2006. The most recent finding regarding the railroads' cost of capital was made in Railroad Cost of Capital - 2005, Ex Parte No. 558 (Sub-No. 9), STB served September 20, 2006 (Cost 05), which determined the industry's 2005 cost of capital. The cost of capital finding made in this proceeding will be used in the determination of railroad revenue adequacy for 2006. It may also be used in other Board railroad proceedings, including, but not necessarily limited to, those involving the prescription of maximum reasonable rate levels; the determination of trackage rights compensation; proposed abandonments of rail lines; railroad mergers; and applications to purchase feeder lines.

The Cost of Capital for 2006

In this proceeding, we seek comment on: (1) the railroads' 2006 current cost of debt capital; (2) the railroads' 2006 current cost of preferred equity capital (if any); (3) the railroads' 2006 cost of common equity capital; and (4) the 2006 capital structure mix of the railroad industry on a market value basis. Our conclusions regarding these matters will be used in our computation of the industry's overall, or composite, cost of capital for 2006.¹

As in the past, the railroad industry's cost of capital will be determined on the basis of data for a sample of railroads. Using the criteria set forth in Railroad Cost of Capital - 1984,

¹ As in the past, the current cost of debt and market-value based capital structure mix will be used in this cost of capital determination. For purposes of consistency, the current cost of preferred equity will also be used. No consideration will be afforded to evidence depicting the embedded costs of debt or preferred equity or the book value capital structure mix.

1 I.C.C.2d 989 (1985), a railroad will be included in the sample base if and only if it meets all of the following criteria during 2006:

- The company is a Class I line-haul railroad.
- If the Class I railroad is controlled by another company, the controlling company is primarily a railroad company and is not already included in the study frame.²
- The company's bonds are rated at least BBB by Standard & Poor's and Baa by Moody's.
- The company's stock is listed on either the New York or the American Stock Exchange.
- The company has paid dividends throughout 2006.

All railroads that meet these criteria shall be included in the sample base for this proceeding.

Comments should focus on the various cost of capital components listed above using the same methodology followed in the 2005 decision. However, if the Board proposes to change the existing methodology, which is being explored in Ex Parte No. 664, it may (as needed) seek supplemental evidence to implement the new alternative approach. At this time we seek the information needed to calculate the 2006 cost of capital under the existing methodology.

Procedural Matters

All Class I railroads shall be respondents in this proceeding. They shall, and other interested parties may, submit evidence to enable the Board to update the cost of capital findings in Cost 05. Two copies of all underlying work papers and background material used to develop that evidence shall be furnished to the Board and be made available, upon request, to other participants in this proceeding.

Cost of capital continues to play an important role in the regulation of railroads. It is the profitability threshold that plays a key role in determining whether a railroad is revenue adequate (in which case certain ratemaking freedoms cannot be exercised). In rail abandonment proceedings cost of capital serves as the basis for determining opportunity costs. In trackage rights cases, cost of capital serves as the basis for calculating the rent for track usage. For ratemaking purposes, cost of capital is used to compute the capital carrying costs for “stand-

² A company is considered to be primarily in the railroad business if at least 50 percent of its total assets are devoted to railroad operations.

alone” rail operations. Given its critical role in the regulation of railroads, it is important that it be determined promptly even if the Board is considering changing the existing approach.

Railroads and others that intend to participate in this proceeding shall file an original and one copy of a notice of intent to participate with the Secretary by the date specified below. Evidentiary statements are to be filed with the Board on or before the dates set forth below. Comments may be submitted either via the Board’s e-filing format or in the traditional paper format. Any person using e-filing should comply with the instructions at the E-FILING link on the Board’s website, at <http://www.stb.dot.gov>. Any person submitting a filing in the traditional paper format should send an original and 10 copies to: Surface Transportation Board, Attn: STB Ex Parte No. 558 (Sub-No. 10), 395 E Street, S.W., Washington, DC 20423-0001. In addition, the evidence contained in the statement shall be submitted on a 3.5-inch disk in MS Word 2003 or its equivalent.

Notices of intent to participate are due no later than May 29, 2007. Statements of the railroads are due by June 25, 2007. Statements of other interested persons are due by July 25, 2007. Rebuttal statements by the railroads are due by August 9, 2007.

Environmental and Energy Considerations

We preliminarily conclude that the proposed action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is Ordered:

1. This proceeding is instituted pursuant to 49 U.S.C. 10704(a)(2) to determine the railroad industry's cost of capital for 2006. Evidence on this matter is required of all Class I railroads, and comments are invited from all other interested persons.
2. Notice will be published in the Federal Register on May 21, 2007.

By the Board, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey.

Vernon A. Williams
Secretary