

SERVICE DATE – MARCH 6, 2009

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 558 (Sub-No. 12)

RAILROAD COST OF CAPITAL - 2008

Decided: March 5, 2009

By this decision, we are instituting a proceeding to determine the railroad industry's cost of capital for 2008. The most recent finding regarding the railroads' cost of capital was made in Railroad Cost of Capital - 2007, Ex Parte No. 558 (Sub-No. 11), STB served Sept. 26, 2008 (Cost 07), which determined the industry's 2007 cost of capital. The cost of capital finding made in this proceeding will be used in the determination of railroad revenue adequacy for 2008. 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 2008

In this proceeding, we seek comment on: (1) the railroads' 2008 current cost of debt capital; (2) the railroads' 2008 current cost of preferred equity capital (if any); (3) the railroads' 2008 cost of common equity capital; and (4) the 2008 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 2008.<sup>1</sup>

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 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 2008:

- The company is a Class I line-haul railroad.

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<sup>1</sup> 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, if any, 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.

- 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.<sup>2</sup>
- 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 2008.

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 methodology followed in the Cost 07 decision, with the exception of applying the Ex Parte No. 664 (Sub No.1) decision in calculating the cost-of-equity. The Board has changed the way it calculates the railroads industry's cost-of-equity component of our annual cost of capital estimates. See Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of capital, STB Ex Parte No. 664 (Sub No. 1) (STB served Jan. 28, 2008). Specifically, the Board will use a simple average of the estimates produced by the CAPM model adopted in STB Ex Parte No. 664 and the Morningstar/Ibbotson model adopted in STB Ex Parte No. 664 (Sub No. 1). At this time we seek the information needed to calculate the 2008 cost of capital under the methodology specified above.

#### 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 07. 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.

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. 12), 395 E Street, S.W., Washington, DC 20423-0001. In addition,

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<sup>2</sup> 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.

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 March 20, 2009. Statements of the railroads are due by April 20, 2009. Statements of other interested persons are due by May 20, 2009. Rebuttal statements by the railroads are due by June 19, 2009.

#### 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 2008. 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 March 11, 2009.

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

Anne K. Quinlan  
Acting Secretary