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SEC

SERVICE DATE – LATE RELEASE JANUARY 17, 2008

SURFACE TRANSPORTATION BOARD

DECISION

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

RAILROAD COST OF CAPITAL – 2006

Decided: January 17, 2008

In a decision released simultaneously with this one, the Board has changed the way it calculates the railroad industry's cost of capital. See Methodology to be Employed in Determining the Railroad Industry's Cost of Capital, STB Ex Parte No. 664 (STB served Jan. 17, 2008). Specifically, the Board will use the Capital Asset Pricing Model (CAPM) to estimate the railroad industry's cost of equity. In the decision instituting this proceeding, the Board noted that it was contemplating this change and indicated that it would, as needed, seek supplemental evidence to implement the new approach. See Railroad Cost of Capital—2006, STB Ex Parte No. 558 (Sub-No. 10) (STB served May 16, 2007).

Under CAPM, the cost of equity is equal to $RF + \beta \times RP$, where RF is the risk-free rate, RP is the market-risk premium, and β (or beta) is the measure of systematic, non-diversifiable risk. In order to calculate the cost of equity under CAPM, the Board requires the following information:

1) For RF: the average yield to maturity in 2006 for a 20-year U.S. Treasury Bond.

2) For RP: the equity risk premium calculated using the S&P 500 from the year 1926. These data are also available from a variety of commercial vendors, including Ibbotson.

3) Parties will calculate beta using a portfolio of weekly, merger-adjusted railroad stock returns for the prior 5 years in the following equation:

$$R - SRRF = \alpha + \beta\,(RM - SRRF) + \varepsilon$$

α	=	constant term;
R	=	merger-adjusted stock returns for the portfolio of railroads that meet the screening criteria set forth in *Railroad Cost of Capital – 1984*, 1 I.C.C.2d 989 (1985);[1]
SRRF	=	the short-run risk-free rate, which we will proxy using the 3-month U. S. Treasury bond rate;
RM	=	return on the S&P 500; and
ε	=	random error term.

Parties are instructed to submit the information, calculations, and supporting workpapers needed to estimate the cost of equity under CAPM approach.

All Class I railroads shall respond to this request for supplemental information. They shall, and other parties to this proceeding may, submit evidence on the cost of equity using CAPM as specified above. Two copies of all underlying workpapers 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.

Given the limited nature of the information requested, and that the carriers have submitted testimony indicating their experts have already performed this analysis, we believe a tight procedural schedule is warranted. Accordingly, railroad statements are due on February 1, 2008. Reply statements of other parties to this proceeding are due on February 15, 2008. Rebuttal statements by the railroads are due by February 29, 2008.

<u>It is ordered</u>:

1. Statements of the railroads are due February 1, 2008. Reply statements of other parties are due on February 15, 2008. Rebuttal statements by the railroads are due by February 29, 2008.

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[1] The criteria are that the carrier: (1) is listed on either the New York or American Stock Exchange; (2) paid dividends throughout the year; (3) had rail assets greater than 50% of its total assets; and (4) had a debt rating of at least BBB (Standard & Poors) and Baa (Moody's). For 2006, the carriers that qualify for inclusion in the portfolio are: BNSF Railway Company, Union Pacific Railroad Company, CSX Transportation, Inc., and Norfolk Southern Railway Company.

2. This decision is effective on the date of service.

By the Board, Anne K. Quinlan, Acting Secretary.

Anne K. Quinlan
Acting Secretary