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SURFACE TRANSPORTATION BOARD

CORRECTED DECISION\*\*

STB Ex Parte No. 558 (Sub-No. 8)

RAILROAD COST-OF-CAPITAL — 2004

Decided: June 21, 2005

Upon review of the evidence tendered in this proceeding, the Board finds that in 2004, the railroad industry had a composite after-tax cost-of-capital of 10.1%, based on: (1) a current cost-of-debt of 5.25%; (2) a current cost of common equity capital of 13.16%; and (3) a capital structure mix of 38.5% debt and 61.5% common equity.

BY THE BOARD:

One of the Surface Transportation Board's regulatory responsibilities is the annual determination of the railroad industry's cost-of-capital.<sup>1</sup> This determination is one component used in evaluating the adequacy of railroad revenues each year under the procedures and standards mandated by Congress in the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) and promulgated in Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981), modified, 3 I.C.C.2d 261 (1986). This finding may also be used in other regulatory proceedings, including, but not necessarily limited to, those involving the prescription of maximum reasonable rate levels, the proposed abandonment of rail lines, and the setting of compensation for disputed trackage rights fees.

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\*\* This decision corrects the Board's decision served today in this proceeding. Please substitute it for the earlier version.

<sup>1</sup> The railroad cost of capital determined here is an aggregate measure for the Class I industry as a whole. It is not intended to measure the desirability of any individual capital investment project.

The most recent determination of the railroad industry's cost-of-capital was for the year 2003 in Railroad Cost of Capital — 2003, STB Ex Parte No. 558 (Sub-No. 7) (STB served June 28, 2004) (Cost 03). The instant proceeding, instituted in Railroad Cost of Capital — 2004, STB Ex Parte No. 558 (Sub-No. 8) (STB served Dec. 20, 2004), updates the railroad industry's cost-of-capital for the year 2004.

The only party to provide evidence in this proceeding was the Association of American Railroads (AAR). The AAR concluded that the composite after-tax cost-of-capital for the railroad industry for 2004 was 10.1%, higher than the 2003 cost-of-capital rate of 9.4%.

Consistent with previous cost-of-capital proceedings, the AAR determined the overall railroad industry cost-of-capital rate using a "composite railroad" consisting of Class I carriers controlled by selected major railroad holding companies. The AAR's selection of these companies was based on criteria developed in Railroad Cost of Capital — 1984, 1 I.C.C.2d 989 (1985).<sup>2</sup> The following companies that met these criteria are: Burlington Northern Santa Fe Corporation (BNSF), CSX Corporation (CSX), Norfolk Southern Corporation (NSC), and the Union Pacific Corporation (UPC).<sup>3</sup>

As discussed below, we have examined the procedures used by the AAR to determine the following for 2004: (1) the railroad industry's current cost-of-debt capital; (2) its cost of common equity capital; (3) its cost of preferred equity capital;<sup>4</sup> (4) its capital structure mix; and (5) the composite after-tax railroad industry cost-of-capital. We have determined that the 2004 railroad cost-of-capital was 10.1%.

## DEBT CAPITAL

The AAR developed its 2004 current cost-of-debt using bond price data from Standard & Poor's Corporation *Bond Guide* and a Standard and Poor's database for those bonds not traded. The AAR's cost-of-debt figure is based on the market value yields of the major forms of long-term debt instruments for the sample railroad holding companies listed above. These debt instruments include: (1) bonds, notes, and debentures (bonds); (2) equipment trust certificates (ETCs); and (3)

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<sup>2</sup> These criteria are as follows: (1) the company is listed on either the New York or American Stock Exchange; (2) the company paid dividends throughout the year; (3) the company's rail assets are greater than 50% of its total assets; and (4) the company has a debt rating of at least BBB (Standard & Poor's) and Baa (Moody's).

<sup>3</sup> These are the same companies included by the AAR and used in our 2003 cost-of-capital decision. See Cost 03.

<sup>4</sup> There was no preferred stock outstanding for 2004.

conditional sales agreements (CSAs). The yields of these debt instruments are weighted based on their market values.

*Cost of Bonds, Notes, and Debentures (Bonds)*

The AAR used data contained in Standard & Poor's *Bond Guide* for the current cost of bonds, based on monthly prices and yields during 2004, for all issues (a total of 63) that were publicly traded during the year. To determine the current (2004) market value of bonds, the AAR used these traded bonds and 70 additional bonds that were outstanding but not traded during 2004. Continuing the procedure in effect since 1988, the AAR based the market value on monthly prices for all traded bonds and the face or par value (\$1,000) for all bonds not traded during the year. The AAR computed the total market value of all outstanding bonds to be \$24.9 billion (\$18.5 billion traded, and \$6.4 billion non-traded). Based on the yields for the traded bonds, the AAR calculated the weighted average 2004 yield for all bonds to be 5.09%. We have examined the AAR's bond price and yield data and have determined that the AAR's computations are correct. Our calculations and data for all bonds are shown in Tables 1 and 2 of the Appendix.

*Cost of Equipment Trust Certificates (ETCs)*

ETCs are not actively traded on secondary markets. Therefore, their costs must be estimated by comparing them to the yields of other debt securities that are actively traded. Following the practice in previous cost-of-capital proceedings, the AAR used government securities with maturities similar to these ETCs as surrogates for determining yields. After determining the 2004 yields for these government securities, the AAR added basis points<sup>5</sup> to these yields to compensate for the additional risks associated with the ETCs.

No new ETCs were issued during 2004. There were 37 ETCs issued prior to 2004 that were outstanding during the year. The AAR determined that the yield spread for ETCs was 114 basis points higher than the yield for government bonds.<sup>6</sup> Using the yield spreads, the AAR calculated the weighted average cost of ETCs to be 5.01%<sup>7</sup> and their market value to be \$1.247 billion for 2004.<sup>8</sup>

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<sup>5</sup> A basis point equals 1/100th of a percentage point.

<sup>6</sup> This figure is same as the spread used in 2003.

<sup>7</sup> This is substantially higher than the 2003 figure of 4.68%.

<sup>8</sup> The AAR has approximated the market values of ETCs using the same procedures used in previous cost-of-capital determinations.

We have analyzed the ETC cost and market value evidence supplied by the AAR and find no errors in the AAR's data. A summary of our ETC computations is shown in Table 3 in the Appendix.

*Cost of Conditional Sales Agreements (CSAs)*

CSAs represent a small fraction (less than 1%) of total railroad debt and only two CSAs issued by CSX were outstanding in 2004. The cost of CSAs, however, can be estimated. The AAR used the yield spread between CSAs and ETCs for 1997 (the last year when a new CSA was issued) of 32 basis points to develop the year 2004 yield spread between CSAs and government bonds. This results in 146 basis points being added to government bond yields to develop the cost of CSAs.<sup>9</sup> Using this yield spread the AAR determined the weighted average cost of CSAs for 2004 to be 5.39%. The AAR determined the market value for CSAs to be \$0.101 billion. We have examined the cost and market value of the CSAs using the AAR's data, and have determined that the AAR failed to include one CSA in its computations.<sup>10</sup> The results of our revised computations are shown in Table 4 in the Appendix.

*Miscellaneous Debt and Capitalized Leases*

As in previous cost-of-capital determinations, the AAR excluded the costs of capitalized leases and miscellaneous debt in its computation of the overall current cost-of-debt because these costs are not directly observable in the open market. Also in keeping with past practice, the AAR included the book value of leases and commercial paper in the overall market value of debt, which is used to determine the railroads' capital structure mix. The AAR noted that the cost of capitalized leases is generally higher than that of other debt, but it did not make any upward correction for the cost of those leases. The AAR determined that the market value for the capitalized leases and miscellaneous debt was \$3.013 billion for 2004.<sup>11</sup> We have examined the AAR's workpapers and other evidence and have determined these figures to be correct. Table 5 in the Appendix shows our recalculations for capitalized leases and miscellaneous debt.

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<sup>9</sup> This yield spread equals the yield spread for ETCs vs. government bonds of 114 basis points plus the yield spread between ETCs and CSAs of 32 basis points. These are the same numbers as used in the 2003 determination.

<sup>10</sup> The AAR approximated the market values of CSAs using the same procedures used in previous cost-of-capital determinations. The AAR included two CSAs issued by CSX. However, the AAR's workpapers show three CSAs issued by CSX outstanding.

<sup>11</sup> This consists of \$2.31 billion of capitalized leases and \$0.714 billion of miscellaneous debt.

*Total Market Value of Debt*

The AAR determined that the total market value for all debt during 2004 was \$29.269 billion. Due to our adjustment for one conditional sales agreement discussed previously, we have recomputed the total market value for all railroad debt in 2004 to be \$29.327 billion. Table 6 in the Appendix shows a breakdown of the market value of debt.

*Flotation Costs of Debt*

As in past cost-of-capital decisions, the AAR's calculation of the current cost-of-debt included a flotation cost factor consisting of costs associated with the issuance of new debt such as underwriters' fees, advertising costs, and legal fees. The AAR determined that flotation costs for debt equaled 0.158% (rounded to 0.16%). We have reviewed the AAR's calculations concerning flotation costs and find that the cost factors developed for the various components of debt are reasonable.<sup>12</sup> Table 7 in the Appendix shows these calculations.

*Overall Current Cost-of-Debt*

The AAR concluded that the railroads' current cost-of-debt for 2004 was 5.26%. Our calculations produce a slightly lower figure (5.25%).<sup>13</sup> Our calculations are shown in Table 8 in the Appendix.

COMMON EQUITY CAPITAL

In previous cost-of-capital decisions, we have determined the cost of common equity using a Discounted Cash Flow (DCF) method. The AAR submitted evidence as to the current cost of equity capital using this procedure. This evidence is virtually identical to that furnished by the AAR in previous cost-of-capital proceedings.

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<sup>12</sup> The AAR's flotation cost factors are based on data developed by Salomon Brothers for ETCs and studies by the Securities and Exchange Commission concerning flotation costs for issuances of new bonds. The estimated flotation cost for CSAs is the same as that used in prior proceedings.

<sup>13</sup> This is slightly higher than the 2003 cost-of-debt (5.00%). As explained above, our measurement of the railroads' cost of debt entails the calculation of a weighted average of the current yields of the various debt instruments issued by the four large railroads in our sample. Year-to-year changes in this measure can differ from changes in other specialized indices of current interest rates for debt instruments incorporating differing time horizons and risks.

*Market Value of Common Equity*

The AAR calculated the 2004 market value of common equity by multiplying the number of shares outstanding by the daily closing price for each trading day during the year for each of the sample railroad holding companies. The AAR determined that the average market value for the year 2004 was \$46.836 billion. We have reviewed the AAR's calculations and have determined that this number is correct. Table 9 in the Appendix shows the calculations of the average market value of common equity and relative weights for each railroad.

*Discounted Cash Flow Method*

The DCF method of determining the cost of common equity is used by the majority of state regulatory agencies and has been used by the Interstate Commerce Commission (ICC) and the Board for many years. Under the DCF method, the cost of common equity is the discount rate that makes the present value of expected returns from holding a stock (dividends and price appreciation) equal to the current market value of that stock. The DCF method considers two variables — dividend yield and expected growth in earnings per share.<sup>14</sup>

*Dividend Yield*

The AAR computed the 2004 average dividend yield for the composite group of railroads using the same method that it employed in past cost-of-capital determinations, *i.e.*, weighting each company's monthly dividend yield on the basis of its prorated share of the total market value for the composite for each day during that month based on daily closing prices. The AAR developed a

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<sup>14</sup> In Railroad Cost of Capital - 1982, 367 I.C.C. 662 (1983), the ICC developed the following DCF formula:

$$K = [D_{(0)} \times (1 + g/2)/P_{(0)}] + g, \text{ where:}$$

K = cost of common equity

$D_{(0)}$  = annual dividend

$P_{(0)}$  = current stock price

g = expected growth rate

This formula assumes that, at the start of the year, an investor would require a return on equity (K) equal to  $[D_{(0)}/P_{(0)}] + g$ , where  $D_{(0)}/P_{(0)}$  represents the average dividend yield expected for the year and g represents an estimate of the expected growth rate. At the end of the year, the investor would be concerned with projected returns for the following year and would require a K equal to  $[D_{(0)} \times (1+g)/P_{(0)}] + g$ , which would allow for dividend growth for the following year. The average of these two formulas produces this DCF formula.

composite dividend yield of 1.67% for 2004. We have reviewed the AAR's calculations and have determined that this number is correct. This figure is slightly higher than the 2003 dividend yield (1.64%). Our calculations of the dividend yield are shown in Table 10 in the Appendix.

### *Growth Rate*

The AAR used the 5-year earnings per-share growth rate forecasts published monthly by the Institutional Brokers Estimate System (IBES) throughout 2004.<sup>15</sup> The AAR developed growth rates for each of the railroad holding companies that make up the composite by averaging the IBES forecasts for that company. It then weighted each company's growth rate according to its prorated share of the market value of the total railroad composite to arrive at a single projected growth rate. The AAR concluded that this composite growth rate was 11.0%, based on a truncated average of the forecasts.<sup>16</sup> We have determined that this is correct. This is 0.13 of a percentage point lower than the 11.13% growth rate developed in the 2003 cost-of-capital decision. Our growth rate calculations are shown in Tables 11 (truncated) and 12 (nontruncated) of the Appendix.

### *Flotation Costs*

As with the issuance of new debt instruments, flotation costs are also incurred with the issuance of new equity securities. In Adequacy of Railroad Revenue (1979 Determination), 362 I.C.C. 344 (1979), the ICC concluded that flotation costs for equity capital should not be considered unless new equity had, in fact, been issued. This conclusion has been reaffirmed in subsequent cost-of-capital decisions. Because no railroad issued any new common equity capital during 2004, no flotation cost factor has been included in the DCF formula.

### *Conclusion - Cost of Common Equity Capital*

Using a truncated average IBES growth rate (g) forecast of 11.39%, a dividend yield ( $D_{(0)}/P_{(0)}$ ) of 1.67%, and the Board's DCF formula, the AAR determined the cost of common

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<sup>15</sup> As has been the case since the findings in Railroad Cost of Capital - 1987, 4 I.C.C.2d 621 (1988), we have relied on the use of consensus analyst 5-year earnings per-share growth rate data published by IBES to develop the growth rate estimates used in the DCF approach. IBES data include growth rate estimates from essentially all major brokerage firms.

<sup>16</sup> IBES provides a simple average, the highest forecast, and the lowest forecast for each railroad. The AAR excluded the highest and lowest forecasts to arrive at the truncated average. This is the same procedure that has been followed in previous cost-of-capital determinations.

equity for 2004 to be 13.16%. This figure is 0.46 percentage point higher than the cost of common equity for 2003 (12.7%).<sup>17</sup>

### PREFERRED EQUITY

Preferred equity has some of the characteristics of debt and some of the characteristics of equity. Essentially, preferred issues are like common stocks in that they have no maturity dates and represent ownership in the company (usually with no voting rights attached). They are like debt in that they usually have fixed dividend payments (akin to interest payments).

There were no preferred stock issues outstanding at the end of 2004.<sup>18</sup>

### CAPITAL STRUCTURE MIX

Our computations of market values and the capital structure mix for 2004 are shown in Table 14 in the Appendix. We have determined that the market value of bonds and common equity for 2004 was \$76.16 billion. The percentage share of common equity increased significantly from 57.2% in 2003 to 61.5% in 2004. The percentage share of debt decreased from 42.8% in 2003 to 38.5% in 2004.

### COMPOSITE COST-OF-CAPITAL

Based on the evidence furnished in the record, and our adjustments to that evidence discussed above, we conclude that the 2004 composite after-tax cost-of-capital for the railroad industry, as set forth in Table 15 in the Appendix, was 10.1%. The procedure used to develop the composite cost-of-capital is consistent with the Statement of Principle established by the Railroad Accounting Principles Board: "Cost of capital shall be a weighted average computed using proportions of debt and equity as determined by their market values and current market rates."<sup>19</sup> The 2004 cost-of-capital is 0.7 percentage point higher than the 2003 cost-of-capital (9.4%).

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<sup>17</sup> Table 13 in the Appendix shows our calculation of the cost of common equity.

<sup>18</sup> Two railroad holding companies, NSC and UPC, redeemed all of their preferred stock and there is no longer any outstanding.

<sup>19</sup> Railroad Accounting Principles Board *Final Report*, Vol. 1 (1987).

## CONCLUSIONS

### We find that for 2004:

1. The current cost of railroad long-term debt was 5.25%.
2. The cost of common equity was 13.16%.
3. The capital structure mix of the railroads was 38.5% long-term debt and 61.5% common equity.
4. The composite railroad industry cost-of-capital was 10.1%.

### Environmental and Energy Considerations

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

### Regulatory Flexibility Analysis

Pursuant to 5 U.S.C. 605(b), we conclude that our action in this proceeding will not have a significant economic impact on a substantial number of small entities. The purpose and effect of the action are merely to compute the annual railroad industry cost-of-capital. No new reporting or other regulatory requirements are imposed, directly or indirectly, on small entities.

### It is ordered:

1. This decision is effective on XX.
2. This proceeding is discontinued.

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

Vernon A. Williams  
Secretary

## APPENDIX

**Table 1**  
**2004 Traded & Non-traded Bonds / Market Value By Company**

<b>Railroad</b>	<b>Traded vs Untraded</b>	<b>Number</b>	<b>Market Value (\$ in 000)</b>	<b>% Market Value to All Bonds</b>
BNSF	Traded	25	\$4,919,693	90.36%
	Non-traded <sup>1</sup>	9	524,926	9.64%
	Total	34	5,444,619	
CSX	Traded	10	2,989,200	46.57%
	Non-traded <sup>2</sup>	31	3,429,795	53.43%
	Total	41	6,418,995	
NSC	Traded	12	5,704,685	82.54%
	Non-traded	8	1,207,085	17.46%
	Total	20	6,911,770	
UPC	Traded <sup>3</sup>	16	4,886,391	79.68%
	Non-traded <sup>4</sup>	22	1,246,304	20.32%
	Total	38	6,132,695	
<b>COMPOSITE</b>	Traded	63	\$18,499,969	74.27%
	Non-traded	70	6,408,110	25.73%
	Total	133	24,908,079	
<sup>1</sup> Includes 1 bond issued during 2004, prorated based on date of issue. <sup>2</sup> Includes 3 bonds issued during 2004, prorated based on date of issue. <sup>3</sup> Includes 1 bond issued during 2004, prorated based on date of issue. <sup>4</sup> Includes 2 bonds issued during 2004, prorated based on date of issue.				

**Table 2**  
**Calculation of 2004 Value and Cost of Bonds, Notes, & Debentures**

<b>Railroad</b>	<b>Number of Traded Issues</b>	<b>Market Value Traded Issues (\$000)</b>	<b>Current Cost</b>	<b>Weighted Cost</b>
BNSF	25	\$4,919,693	5.32%	1.41%
CSX	10	2,989,200	4.85%	0.78%
NSC	12	5,704,685	5.45%	1.68%
UPC	16	4,886,391	4.63%	1.22%
<b>Composite</b>	<b>63</b>	<b>\$18,499,969</b>		<b>5.09%</b>

**Table 3**  
**Calculation of 2004 Value and Cost of Equipment Trust Certificates**

<b>Railroad</b>	<b>No. of Issues</b>	<b>Market Value (\$000)</b>	<b>Yield %</b>	<b>Weighted \$ Yield (\$000)</b>
BNSF	11	\$324,213	4.97%	\$16,114
CSX	12	427,920	5.00%	21,414
NSC	8	246,784	4.98%	12,279
UPC	6	247,642	5.13%	12,693
<b>Composite</b>	<b>37</b>	<b>\$1,246,559</b>	<b>5.01%</b>	<b>\$62,500</b>

**Table 4**  
**Calculation of 2004 Value and Cost of Conditional Sales Agreements**

<b>Railroad</b>	<b>Number of Issues</b>	<b>Market Value (\$000)</b>	<b>Current Cost</b>	<b>Weighted Cost</b>
CSX	3	\$159,558	5.39%	5.39%
<b>Composite</b>	<b>3</b>	<b>\$159,558</b>		<b>5.39%</b>

**Table 5**  
**Calculation of 2004 Value of Capitalized Leases & Miscellaneous Debt**

<b>Railroad</b>	<b>Capitalized Leases (\$000)</b>	<b>Miscellaneous Debt (\$000)</b>	<b>Total Other Debt (\$000)</b>
BNSF	\$631,812	\$159,089	\$790,901
CSX <sup>1</sup>	145,262	(8,831)	136,431
NSC	124,344	660,162	784,506
UPC <sup>1</sup>	1,406,462	(105,000)	1,301,462
<b>Composite</b>	<b>\$2,307,880</b>	<b>\$705.4</b>	<b>\$3,013,300</b>
<sup>1</sup> CSX and UPC have negative miscellaneous debt as a result of unamortized debt premium.			

**Table 6**  
**Calculation of 2004 Market Value of Debt**

<b>Type of Debt</b>	<b>Market Value of Debt (\$000)</b>	<b>Percentage of Total Market Value (Excluding Miscellaneous Debt)</b>
Bonds, Notes, & Debentures	\$24,908,079	94.66%
ETCs	1,246,558	4.74%
CSAs	159,558	0.60%
Subtotal	\$26,314,195	100.00%
Capitalized Leases/Miscellaneous Debt	3,013,300	NA
<b>Total Market Value of Debt</b>	<b>\$29,327,495</b>	<b>NA</b>

**Table 7**  
**Calculation of 2004 Flotation Cost For Debt**

<b>Type of Debt</b>	<b>Market Weight (Excludes Miscellaneous Debt)</b>	<b>Flotation Cost</b>	<b>Weighted Average Flotation Cost</b>
Bonds, Notes, & Debentures	94.66%	0.16%	0.151%
ETCs	4.74%	0.13%	0.006%
CSAs	0.60%	0.13%	0.001%
<b>Total</b>	<b>100.00%</b>		<b>0.158%</b>

**Table 8**  
**Calculation of 2004 Cost-of-debt**

<b>Type of Debt</b>	<b>Percentage of Total Market Value (Excludes Miscellaneous Debt)</b>	<b>Debt Cost</b>	<b>Weighted Debt Cost (Excluding Miscellaneous Debt)</b>
Bonds, Notes, & Debentures	94.66%	5.09%	4.82%
ETCs	4.74%	5.01%	0.24%
CSAs	0.60%	5.39%	0.03%
Subtotal			5.09%
Flotation Cost			0.16%
<b>Weighted Average Cost- of-debt</b>			<b>5.25%</b>

**Table 9**  
**Calculation of 2004 Market Value and Weights of Common Equity**

<b>Railroad</b>	<b>Average Market Value (\$000)</b>	<b>Average Market Weight</b>
BNSF	\$13,440,204.8	28.7%
CSX	7,110,186.0	15.2%
NSC	10,567,300.0	22.6%
UPC	15,718,504.9	33.5%
<b>COMPOSITE</b>	<b>\$46,836,195.7</b>	<b>100.00%</b>

**Table 10**  
**Calculation of 2004 Dividend Yields for Common Equity**

<b>Railroad</b>	<b>Average Weight In Composite</b>	<b>Dividend Yield</b>	<b>Weighted Dividend Yield</b>
BNSF	28.7%	1.80%	0.52%
CSX	15.2%	1.22%	0.18%
NSC	22.6%	1.36%	0.31%
UPC	33.5%	1.98%	0.66%
<b>COMPOSITE</b>	<b>100.00%</b>		<b>1.67%</b>

**Table 11**  
**Calculation of 2004 Truncated Growth Rates**

<b>Railroad</b>	<b>Average Weight In Composite</b>	<b>Truncated Average Growth Rate</b>	<b>Contribution To Truncated Average Growth Rate</b>
BNSF	28.7%	10.91%	3.13%
CSX	15.2%	11.71%	1.78%
NSC	22.6%	12.47%	2.82%
UPC	33.5%	10.93%	3.66%
<b>COMPOSITE</b>	<b>100.00%</b>		<b>11.39%</b>

**Table 12**  
**Calculation of 2004 Nontruncated Growth Rates**

<b>Railroad</b>	<b>Average Weight In Composite</b>	<b>Nontruncated Average Growth Rate</b>	<b>Contribution To Nontruncated Average</b>
BNSF	28.7%	10.78%	3.09%
CSX	15.2%	12.12%	1.84%
NSC	22.6%	12.46%	2.82%
UPC	33.5%	10.69%	3.58%
<b>COMPOSITE</b>	<b>100.00%</b>		<b>11.33%</b>

**Table 13**  
**Computation of the 2004 Cost of Common Equity**

Dividend Yield	1.67%	
Dividend Yield Times 1+½ Growth Rate	1.67% x (1+.05695)	1.77%
Growth Rate		11.39%
<b>Cost of Equity</b>		<b>13.16%</b>

**Table 14**  
**Computation of 2004 Capital Structure Mix**

<b>Railroad</b>	<b>Type of Capital</b>	<b>Market Value</b>	<b>Weight</b>
BNSF	Debt	6,559,733	32.8%
	Equity	13,440,205	67.2%
CSX	Debt	7,142,904	50.1%
	Equity	7,110,186	49.9%
NSC	Debt	7,943,060	42.9%
	Equity	10,567,300	57.1%
UPC	Debt	7,681,799	32.8%
	Equity	15,718,505	67.2%
Composite Weight	Debt	29,327,496	38.5%
	Equity	46,836,196	61.5%
	Total	76,163,692	100.0%

**Table 15**  
**2004 Cost-of-capital Computation**

<b>Railroad</b>	<b>Type of Capital</b>	<b>Cost (Rounded)</b>	<b>Weight</b>	<b>Weighted Average</b>	
BNSF	Debt	5.46%	32.80%	1.79%	
	Equity	12.81%	67.20%	8.61%	
	Cost of Capital			100.00%	10.40%
CSX	Debt	5.05%	50.11%	2.53%	
	Equity	13.00%	49.89%	6.49%	
	Cost of Capital			100.00%	9.02%
NSC	Debt	5.59%	42.91%	2.40%	
	Equity	13.91%	57.09%	7.94%	
	Cost of Capital			100.00%	10.34%
UPC	Debt	4.81%	32.83%	1.58%	
	Equity	13.02%	67.17%	8.75%	
	Cost of Capital			100.00%	10.32%
Composite Weight	Debt	5.25%	38.51%	2.02%	
	Equity	13.16%	61.49%	8.09%	
	Cost of Capital			100.00%	10.11%
	<b>Rounded to</b>				<b>10.1%</b>