

EB

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 558 (Sub-No. 1)

RAILROAD COST OF CAPITAL - 1997

Decided: December 5, 1997

By this decision, we are instituting a proceeding to determine the railroad industry's cost of capital for 1997. The most recent finding regarding the railroads' cost of capital was made in Railroad Cost of Capital - 1996, STB served July 16, 1997 (Cost 96), which determined the industry's 1996 cost of capital. The cost of capital finding made in this proceeding will be used in the determination of railroad revenue adequacy for 1997.¹ 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 proposed abandonments of rail lines, railroad mergers, and applications to purchase feeder lines.

The Cost of Capital for 1997

In this proceeding, we seek comment on: (1) the railroads' 1997 current cost of debt capital; (2) the railroads' 1997 current cost of preferred equity capital; (3) the railroads' 1997 cost of common equity capital; and (4) the 1997 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 1997.²

¹ In Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981), the Interstate Commerce Commission determined that the appropriate standard for measuring the adequacy of railroad revenues is a rate of return on net investment equal to or greater than the industry's current cost of capital. The appropriateness of this standard was reaffirmed in Standards for Railroad Revenue Adequacy, 3 I.C.C.2d 261 (1986) (Standards II).

² In accordance with the ICC's conclusions in Standards II, 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
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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 1997:

- 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.³

- 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 1997.

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 and the underlying techniques and methodologies used to develop them.

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 96.

(...continued)
to evidence depicting the embedded costs of debt or preferred equity or the book value capital structure mix.

³ 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.

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 Office of the Secretary by the date specified below. To conserve time, avoid unnecessary expense, and limit the service of statements in this proceeding only to active participants, each notice of intent to participate shall include a detailed statement of: (1) whether the person's interest extends merely to receiving releases from the Board in this proceeding; (2) whether the person wishes to participate by filing and receiving statements; (3) whether, if the person wishes to file statements, its interests can be consolidated with those of other participants by the filing of joint statements; and (4) any other pertinent information to aid in limiting the service list to be issued in this proceeding. We will prepare and make available to all parties submitting notices of intent to participate a service list containing the names and addresses of all participants.

Evidentiary statements are to be filed with the Office of the Secretary on or before the dates set forth below. An original and 10 copies of each statement shall be filed with the Board, and one copy shall be served upon each person on the service list. In addition, the evidence contained in the statement shall be submitted on a 3.5 inch disk in Word Perfect 6.1 or its equivalent.

Notices of intent to participate are due no later than December 30, 1997. A service list will then be prepared and issued by January 14, 1998. Statements of the railroads are due by March 20, 1998. Statements of other interested persons are due by April 10, 1998. Rebuttal statements by the railroads are due by April 24, 1998.

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 1997. Comments on this matter are required of all class I railroads and are invited from all other interested persons.

2. Notice will be published in the Federal Register on December 17, 1997.

By the Board, Chairman Morgan and Vice Chairman Owen.

Vernon A. Williams

Secretary

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