

SERVICE DATE – MARCH 2, 2016

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 558 (Sub-No. 19)

RAILROAD COST OF CAPITAL—2015

Digest:<sup>1</sup> The agency is initiating a proceeding in which certain of the nation's largest railroads must, and other interested parties may, provide comments to assist the Board in determining the railroad industry's cost of capital for 2015. The cost-of-capital figure represents the Board's estimate of the average rate of return needed to persuade investors to provide capital to the freight rail industry. This figure, which is calculated each year, is an essential component of many of the agency's core regulatory responsibilities.

Decided: March 1, 2016

By this decision, we are instituting a proceeding to determine the railroad industry's cost of capital for 2015.<sup>2</sup> The most recent finding regarding the railroad industry's cost of capital was made in Railroad Cost of Capital—2014, EP 558 (Sub-No. 18) (STB served Aug. 7, 2015), which determined the industry's 2014 cost of capital. The cost of capital finding made in this proceeding will be used in the determination of railroad revenue adequacy for 2015. It may also be used in other Board railroad proceedings, including, but not limited to, those involving the prescription of maximum reasonable rate levels; the determination of trackage rights compensation; the proposed abandonments of rail lines; railroad mergers; and applications to purchase feeder lines.

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<sup>1</sup> The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

<sup>2</sup> This decision does not affect the Board's decision instituting a rulemaking proceeding in response to the Western Coal Traffic League's petition requesting that the Board modify the methodology used to calculate the cost of equity. See Pet. of the W. Coal Traffic League to Institute a Rulemaking Proceeding to Abolish the Use of the Multi-Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital, EP 664 (Sub-No. 2) (STB served Dec. 20, 2013). In that proceeding, the Board invited comments addressing the cost of equity component of the Board's cost of capital calculation. A public hearing was held on July 22-23, 2015, to further examine certain issues raised in Docket No. EP 664 (Sub-No. 2). The record in that proceeding closed on August 6, 2015, and is now pending before the Board.

### The Cost of Capital for 2015

In this proceeding, we seek comment on the following issues: (1) the railroads' 2015 current cost of debt capital; (2) the railroads' 2015 current cost of preferred equity capital (if any); (3) the railroads' 2015 cost of common equity capital; and (4) the 2015 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 2015.<sup>3</sup>

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 it meets all of the following criteria during 2015:

- 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;<sup>4</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 Stock Exchange (NYSE) or the American Stock Exchange (AMEX);<sup>5</sup> and
- The company has paid dividends throughout 2015.

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<sup>3</sup> 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 structure mix.

<sup>4</sup> A company is considered to be primarily in the railroad business if at least 50% of its total assets are devoted to railroad operations.

<sup>5</sup> The Board notes that CSX Corporation (CSX), a Class I carrier, transferred its stock exchange listing from the NYSE to the Nasdaq Global Select Market (Nasdaq), effective after the market closed on December 21, 2015. For purposes of the 2015 cost-of-capital determination, the Board will waive its requirement that a company's stock must be listed on either the NYSE or the AMEX in the year for which the cost of capital is being determined. This requirement was "designed to insure the availability of stock price data." Railroad Cost of Capital—1984, 1 I.C.C.2d at 1004. Here, because CSX's stock price data was reported on the NYSE and/or the Nasdaq in 2015, we have available stock price data that can be used in the Board's computation of the rail industry's cost of capital for 2015.

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 Railroad Cost of Capital—2014.

Procedural Matters

All Class I railroads that meet the criteria described above 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 Railroad Cost of Capital—2014. 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. The data and information contained in the submitted workpapers must be sufficient to allow replication of the calculations contained therein.

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 Board 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 system 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: Docket No. EP 558 (Sub-No. 19), 395 E Street, S.W., Washington, DC 20423-0001. In addition, any spreadsheets submitted shall be in MS Excel 2010, or a previous version.

Notices of intent to participate will be due by March 30, 2016. Statements of the railroads will be due by April 20, 2016. Statements of other interested persons will be due by May 11, 2016. Rebuttal statements by the railroads will be due by June 1, 2016.

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 2015. Evidence on this matter is required of all Class I railroads that meet the criteria of a sample railroad as described in Railroad Cost of Capital—1984, and comments are invited from all other interested persons.

2. Notices of intent to participate are due by March 30, 2016. Statements of the railroads are due by April 20, 2016. Statements of other interested persons are due by May 11, 2016. Rebuttal statements by the railroads are due by June 1, 2016.

3. Notice of this decision will be published in the Federal Register on March 7, 2016.

4. This decision is effective on its date of service.

By the Board, Chairman Elliott, Vice Chairman Miller, and Commissioner Begeman.