UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 664

METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL

COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY

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Dated: September 27, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte 664

METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S COST OF CAPITAL

COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY

Norfolk Southern Railway Company ("NS") hereby submits its Comments pursuant to the Board's decision served August 31, 2007, and in response to the Notice served on August 20, 2007, in this Ex Parte No. 664, *Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital.*

Norfolk Southern is fully supportive of the comments filed by the Association of American Railroads. NS has invested billions of dollars to maintain and expand its network and believes even larger sums will be needed in the years ahead to meet the demand for freight transportation. Since there is a clear link between the cost of capital and the level of capital expenditures we can make, this proceeding could be a key factor as to whether we will be able to make sufficient investments in our infrastructure to meet the projected demand.

We recognize that the Board has stated that it intends to address only the cost of capital in this proceeding. The cost of capital cannot be viewed in isolation, however, as it is inextricably linked with revenue adequacy. Accordingly, the Board should examine replacement cost analysis for use when making its annual revenue adequacy determinations. Likewise, we will continue to explore the feasibility of determining revenue adequacy on a replacement cost basis.

As to the Board's proposed change in its methodology to calculate the rail industry's cost of capital, we cannot say that CAPM is an unreasonable choice. However, we believe that implementation is more important than methodology. The capital asset pricing model (CAPM), discounted cash flow (DCF), the Ohlson-Juettuer model and others can yield reasonable results. <u>If properly applied</u>, the results of the different methodologies should fall within a fairly narrow band. Indeed, NS looks at its own cost of capital from both a DCF and CAPM perspective and finds the two methodologies produce reasonably similar results.

We believe the fact that the STB's (revised) finding of 7.5% is significantly below the estimate of Wall Street requires the Board to revisit its application of the CAPM methodology.

In the current environment, it is particularly important that the STB not have an unrealistically low cost of capital. The rail industry is the only mode that is spending billions of its own dollars to increase capacity of the surface freight transportation network. Investors are following this proceeding and have made it clear to us in meeting after meeting that the lower the STB's cost of capital, the lower the level of future capital expenditures they expect us to have.

If the goal is to have a rail network to meet projected demand, this is the worst possible moment for the STB to implement a new cost of capital methodology in a manner that results in an unrealistically low cost of capital.

Respectfully Submitted,

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