

Thank you Chairman Nottingham. Good morning and welcome to our panelists from the Federal Reserve Board, shipper and railroad organizations, analysts and guests. I am pleased that we have convened today's hearing on the Cost of Capital. The Board's purpose of calculating the cost of capital is primarily for use as a benchmark for determining whether the railroads are revenue adequate or not.

In examining our methods today, we are fulfilling several Board mandates and policy objectives. One is to periodically review our cost accounting rules and make changes in those rules as required. Another is to ensure the availability of accurate cost information in regulatory proceedings. And yet another is to encourage honest and efficient management of railroads.

It is important to note that the approach we take in calculating the cost of capital not only determines railroad revenue adequacy, but also has implications for our rate cases, abandonments, and for the Uniform Railroad Costing System, or URCS. The ICC adopted the DCF approach approximately 25 years ago. As such, perhaps the more appropriate inquiry today is not whether or not it was the best approach at that time, but rather, "Is it the best approach today?"

There have been numerous advances in finance theory over the last few decades, especially in our understanding of and ability to empirically estimate and measure risk and risk premiums. Those need to be taken account of in the cost of capital calculation.

Today's hearing will explore the arguments made by some that our current method — the Discounted Cash Flow (DCF) approach — is seriously flawed, and that we should consider alternatives. One approach to address their critiques would be to change how we conduct the DCF analysis. Another approach would be to replace our DCF analysis entirely with the so-called CAPM methodology. And yet another approach would be for us to combine certain elements of, or to average, both the DCF and CAPM analyses.

I personally am not wedded to any approach. Rather, I want to ensure that we are using the most accurate and acceptable method today. In that vein, I am eager to hear today's testimony and to engage in dialog with our witnesses.