

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 558 (Sub-No. 22)

RAILROAD COST OF CAPITAL—2018

Digest:¹ 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 2018. 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: February 14, 2019

By this decision, the Board is instituting a proceeding to determine the railroad industry's cost of capital for 2018. The most recent finding regarding the railroad industry's cost of capital was made in Railroad Cost of Capital—2017, EP 558 (Sub-No. 21) (STB served Dec. 6, 2018), which determined the industry's 2017 cost of capital. The cost-of-capital finding made in this proceeding will be used in the determination of railroad revenue adequacy for 2018. 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.

The Cost of Capital for 2018

In this proceeding, the Board seeks comment on the following issues: (1) the railroads' 2018 current cost of debt capital; (2) the railroads' 2018 current cost of preferred equity capital (if any); (3) the railroads' 2018 cost of common equity capital; and (4) the 2018 capital structure mix of the railroad industry on a market value basis. The Board's conclusions regarding these matters will be used in its computation of the industry's overall, or composite, cost of capital for 2018.²

¹ 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).

² 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
(continued . . .)

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 2018:

- 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 Stock Exchange (NYSE) or the Nasdaq Stock Market (NASDAQ);⁴ and
- The company has paid dividends throughout 2018.

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—2017.

By decision served on July 27, 2018, the Board sought comment on whether it would be appropriate to, among other things, make a one-time adjustment to the 2017 annual cost-of-capital determination to remove the accounting impacts of the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017), on rail carriers' deferred tax liability. R.R. Revenue Adequacy—2017 Determination, EP 552 (Sub-No. 22) et al., slip op. at 2-4 (STB served July 27, 2018). Specifically, with respect to the annual cost-of-capital determination, the Board proposed to increase the deferred taxes figures for each of the four carriers comprising the "composite railroad" by the amount of deferred tax liability removed due to the revaluation, while also removing the same amount from the carriers' net income figures. Id. at 3-4. The Board adopted

(. . . continued)

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.

³ A company is considered to be primarily in the railroad business if at least 50% of its total assets are devoted to railroad operations.

⁴ In Revisions to the Cost-of-Capital Composite Railroad Criteria, EP 664 (Sub-No. 3) (STB served Oct. 25, 2017), the Board updated the fourth screening criterion to require a company's stock to be listed on either the NYSE or the NASDAQ, rather than on either the NYSE or the American Stock Exchange (AMEX), as the AMEX no longer exists.

this proposal in Railroad Revenue Adequacy—2017 Determination, EP 552 (Sub-No. 22) et al., slip op. at 4-6 (STB served Dec. 6, 2018). Consistent with the decisions in that docket, comments and data submitted in this proceeding must account for the adjustments made to the 2017 cost-of-capital determination.

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—2017. 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 at www.stb.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. 22), 395 E Street, S.W., Washington, DC 20423-0001. In addition, any spreadsheets submitted shall be in MS Excel 2016, or a previous version.

Notices of intent to participate will be due by April 1, 2019. Statements of the railroads will be due by April 22, 2019. Statements of other interested persons will be due by May 13, 2019. Rebuttal statements by the railroads will be due by June 3, 2019.

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 2018. Evidence on this matter is required of all Class I railroads that meet the criteria of a sample railroad as described above, and comments are invited from all other interested persons.

2. Notices of intent to participate are due by April 1, 2019. Statements of the railroads are due by April 22, 2019. Statements of other interested persons are due by May 13, 2019. Rebuttal statements by the railroads are due by June 3, 2019.

3. Notice of this decision will be published in the Federal Register.

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

By the Board, Board Members Begeman, Fuchs, and Oberman.