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SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 646 (Sub-No. 2)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES— TAXES IN REVENUE SHORTFALL ALLOCATION METHOD

Decided: June 25, 2008

AGENCY: Surface Transportation Board.

ACTION: Notice.

SUMMARY: The Surface Transportation Board seeks public comments on a proposal to adjust its Revenue Shortfall Allocation Method (RSAM), which is a component of its simplified standards for reviewing the reasonableness of a challenged rail rate, in order to account for taxes.

DATES: Comments are due by August 1, 2008. Reply comments are due by September 2, 2008. Rebuttal comments are due by September 22, 2008.

ADDRESSES: Comments may be submitted either via the Board's e-filing format or in the traditional paper format. Any person using e-filing should file a document and otherwise 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: STB Ex Parte No. 646 (Sub-No.2), 395 E Street, S.W. Washington, DC 20423-0001.

Copies of written comments will be available for viewing and self-copying in the Board's Public Docket Room, Room 131, and will be posted to the Board's website.

FOR FURTHER INFORMATION CONTACT: Timothy Strafford at 202-245-0356. [Assistance for the hearing impaired is available through the Federal Information Relay Service (FIRS) at 1-800-877-8339.]

SUPPLEMENTARY INFORMATION: The RSAM figure is one of three benchmarks that together are used to determine the reasonableness of a challenged rail rate. Each benchmark is expressed as a ratio of revenues to variable costs (R/VC ratio). RSAM is intended to measure the average markup that the railroad would need to collect from all of its "potentially captive traffic" (traffic with an R/VC ratio above 180%) to earn adequate revenues as measured by the Board under 49 U.S.C. 10704(a)(2) (i.e., earn a return on investment equal to the railroad industry cost of capital). The second benchmark, the $R/VC_{>180}$ benchmark, measures the average markup over variable cost currently earned by the defendant railroad on its potentially captive traffic. The third benchmark, the R/VC_{comp} benchmark, is used to compare the markup being paid by the challenged traffic to the average markup assessed on other comparable potentially captive traffic.

In Simplified Standards for Rail Rate Cases, STB Ex. Parte 646 (Sub-No. 1) (STB served Sept. 5, 2007) (Simplified Standards), the Board changed the way the RSAM benchmark is calculated to address a flaw in that calculation.[1] Under the current RSAM formula, the Board uses the confidential Carload Waybill Sample[2] to estimate the total revenues earned by the carrier on potentially captive traffic ($REV_{>180}$) and the total variable costs of the railroad to handle that traffic ($VC_{>180}$). The Board also uses the carrier's revenue shortfall (or overage) shown in the Board's annual revenue adequacy determination ($REV_{short/overage}$). RSAM is then calculated as follows:

$$RSAM = (REV_{>180} + REV_{short/overage}) \div VC_{>180}$$

In E.I. DuPont de Nemours and Co. v. CSX Transportation, Inc., STB Docket Nos. 42099, 42100, and 42101 (the DuPont cases), CSX Transportation, Inc. (CSXT) raised an issue with this RSAM formula. It observed that the revenue shortfall ($REV_{short/overage}$) – which is calculated as the difference between the return on net investment that a carrier needs to earn in order to achieve revenue adequacy and the amount that the carrier actually earns – is calculated after all taxes have been paid, and are thus stated on an "after-tax" basis. However, the revenues to which the revenue adequacy shortfall is added ($REV_{>180}$), are calculated before any allowance for taxes, and are thus stated on a "pre-tax" basis. Therefore, CSXT asserted that the inclusion of an "after-tax" revenue shortfall would not provide sufficient revenues to achieve adequate revenues once the additional revenues are subject to taxes.

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[1] Previously, RSAM had been calculated by computing the uniform markup above variable cost that would be needed from all potentially captive traffic "for the carrier to recover all of its URCS fixed costs." Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004, 1027 (1996). When a carrier is not "revenue adequate" under the Board's annual calculations, its RSAM figure (what it needs to collect) should be greater than its $R/VC_{>180}$ figure (what it is actually collecting) and, conversely, when a carrier is "revenue adequate" its RSAM figure should be less than or equal its $R/VC_{>180}$ figure. The problem was that this relationship between RSAM and $R/VC_{>180}$ did not hold true under the Board's prior method. See, e.g., Simplified Standards at 19-20.

[2] The Carload Waybill Sample is a statistical sampling of railroad waybills that is collected and maintained for use by the Board and by the public (with appropriate restrictions to protect the confidentiality of individual traffic data). See 49 CFR 1244.

In the DuPont cases, CSXT proposed that, to correct this deficiency, the Board change the RSAM formula adopted in Simplified Standards by applying the Federal statutory tax rate of 35% in conjunction with CSXT's railroad-specific state tax rate of 4.9% to convert the after-tax shortfall to a pre-tax level. But DuPont argued that no adjustment to the RSAM formula was necessary because the revenue adequacy adjustment factor is overstated. It argued that this overstatement occurs because the variable costs used to calculate the RSAM and $R/VC_{>180}$ benchmarks include an over-recovery of income taxes as measured by the Uniform Rail Costing System. This over-recovery of income taxes raises the variable costs, thereby understating the total revenue from potentially captive traffic with R/VC greater than 180% ($REV_{>180}$). Less revenue from traffic moving at R/VC greater than 180%, in turn, increases the revenue adequacy adjustment factor. Alternatively, DuPont argued that, if the Board were to adjust the RSAM formula to account for taxes, it should use an "effective" or "marginal" tax rate, rather than the statutory tax rate advocated by CSXT.

In this rulemaking, the Board seeks broader public input on whether to modify the RSAM formula adopted in Simplified Standards and, if so, what tax rate should be used to adjust the revenue adequacy shortfall. Commenters are asked to address the following issues. First, does the treatment of taxes in URCS make the adjustment to RSAM unnecessary, as DuPont suggested? Second, if an adjustment is appropriate, should the statutory, effective or marginal tax rate be used? Third, should the Board use the railroad's individual tax rate or an industry average tax rate? Finally, how should the appropriate tax rate be applied to calculate a pre-tax revenue shortfall?[3]

The Board seeks comments on these questions and on any other methodologies that could be used in accounting for taxes under the RSAM benchmark.

Pursuant to 5 U.S.C. 605(b), the Board certifies that the proposed action will not have a significant economic effect on a substantial number of small entities within the meaning of the Regulatory Flexibility Act. No new reporting requirements will be instituted.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

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[3] In abandonment cases, the Board applies Federal and state taxes to convert the cost of capital to a pre-tax cost of capital by dividing the cost of equity by one minus the sum of the Federal and state tax rates.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey.

Anne K. Quinlan
Acting Secretary