39634 SERVICE DATE – JANUARY 30, 2009
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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: January 23, 2009

This decision directs the Association of American Railroads (AAR), and permits other parties, to file supplemental evidence so that the Board has a full record on which to base its methodology to calculate a railroad-specific average state tax rate for use in the Revenue Shortfall Allocation Method (RSAM).

BACKGROUND

Recently, we found that the failure to include state and federal taxes in RSAM calculations was material error.[1] RSAM is one of three benchmarks that together are used to determine the reasonableness of a challenged rail rate under the Board's "Three-Benchmark" approach available for small disputes. RSAM is intended to measure the average markup that the railroad would need to collect from all of its potentially captive traffic (traffic with a ratio of revenues to variable costs 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's cost of capital). RSAM is calculated annually as a 4-year rolling average for each Class I railroad.

In Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007) (Simplified Standards), the Board changed the way the RSAM benchmark was calculated to address a flaw the agency had identified in that formula. Recent cases, however, revealed a second flaw that had previously escaped the attention of the parties and the Board: the failure of the RSAM formula to account for taxes. In E.I. DuPont de Nemours & Co. v. CSX Transportation, Inc., STB Docket Nos. 42099, 42100, and 42101 (the DuPont cases), CSX Transportation, Inc. (CSXT) 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—has been calculated after all taxes have been paid, and thus has been stated on an after-tax basis. However, the revenues to which the revenue adequacy shortfall is added ($REV_{>180}$) are

[1] See Simplified Standards for Rail Rate Cases—Taxes in Revenue Shortfall Allocation Method, STB Ex Parte No. 646 (Sub-No. 2) (STB served Nov. 21, 2008).

calculated before any allowance for taxes, and are thus stated on a pre-tax basis. Therefore, CSXT asserted, the reliance on an after-tax shortfall would not be sufficient to achieve adequate revenues because those additional monies would be subject to taxes.

CSXT had asked that the Board address this matter in the DuPont cases. But we determined that it would not be advisable to make an ad hoc adjustment in those individual cases. Instead, we instituted this proceeding to obtain broader public input on the magnitude of the problem and what, if any, correction to make. We found that there was a material error in the RSAM formula in its failure to account for federal and state taxes, and we revised the formula to correct this error. Specifically, we concluded that the use of the statutory federal tax rate, combined with a railroad-specific weighted average state tax rate, best approximates the marginal taxes that the carrier would pay on the incremental revenue hypothesized by RSAM.

DISCUSSION AND CONCLUSIONS

In this proceeding, AAR has argued that we should calculate an average state tax rate for each Class I railroad as a weighted average using the route-miles of track for each railroad in each state and the state tax rates.[2] AAR advocated that the railroad-specific state tax rate would be calculated based on the corporate income tax rate in each state a carrier operates and the number of miles operated in each state. However, AAR did not file any evidence to allow the Board to make the calculations necessary to evaluate this methodology.

AAR is now directed to submit the evidence and calculations necessary to establish carrier-specific average state tax rates for each Class I railroad. That will include state corporate income tax rates and the number of miles operated by each carrier in each state it operates in for each of the years 2002-2007.[3] Though AAR did not specify exactly how the mileage in each state should be calculated, we propose that AAR use information from the railroads' respective R-1 Schedule 702 (Miles of Road at Close of Year—By States and Territories (Single Track)) to calculate the route-mile portion of the average state tax rate equation. Specifically, we propose that AAR use column (g) of Schedule 702, which is the total miles operated, including both "line owned" and "line operated under trackage rights." AAR should then also calculate carrier-specific state tax rates, for each of the years 2002-2007. All workpapers supporting those calculations must be submitted to the Board.

Interested persons may then comment on the calculations for the carriers within 20 days. Any party (including the carriers) that advocates a different method for calculating the carrier-specific state tax rates should include evidence and workpapers to support its alternative calculations. AAR will be given 14 days to file rebuttal comments. Once we resolve any disputes over how to calculate the carrier-specific state tax rates, we will publish the new RSAM figures.

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[2] See AAR Comments at 7.

[3] We require 2002 through 2007 tax information in order to correct the error in the 2005 RSAM calculation, Rate Guidelines – Non Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served Dec. 20, 2007), and to calculate the 2006 and 2007 RSAM figures.

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

It is ordered:

1. AAR shall submit the evidence described above by February 19, 2009.

2. Replies, if any, are due March 11, 2009.

3. AAR's rebuttal evidence is due March 25, 2009.

4. This decision is effective on its service date.

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

Anne K. Quinlan
Acting Secretary