Federal Register

Thursday,

March 10, 2005

Part III

Department of Homeland Security

Coast Guard

46 CFR Part 401

Rates for Pilotage on the Great Lakes; Interim Rule

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

46 CFR Part 401

[USCG–2002–11288]

RIN 1625–AA38 (Formerly RIN 2115–AG30)

Rates for Pilotage on the Great Lakes

AGENCY: Coast Guard, Department of Homeland Security.

ACTION: Interim rule; request for comments.

SUMMARY: The Coast Guard is changing the rates for pilotage on the Great Lakes. The last full-rate adjustment for pilotage on the Great Lakes became effective in August 2001, and a partial-rate adjustment became effective January 12, 2004. This change is necessary both to generate sufficient revenues for allowable expenses and to ensure that the pilots receive target compensation.

DATES: This interim rule is effective April 11, 2005. Comments and related material must reach the Docket Management Facility on or before June 8, 2005.

ADDRESSES: You may submit comments identified by Coast Guard docket number USCG–2002–11288 to the Docket Management Facility at the U.S. Department of Transportation. To avoid duplication, please use only one of the following methods:

(1) Web site: *http://dms.dot.gov.*

(2) Mail: Docket Management Facility, U.S. Department of Transportation, 400 Seventh Street, SW., Washington, DC 20590–0001.

(3) Fax: 202–493–2251.

(4) Delivery: Room PL–401 on the Plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The telephone number is 202–366–9329.

(5) Federal eRulemaking Portal: *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call Paul Wasserman, Director, Great Lakes Pilotage, Office of Waterways Management Plans and Policy (G–MWP), U.S. Coast Guard, telephone 202–267–2856 or e-mail him at *pwasserman@comdt.uscg.mil.* If you have questions on viewing or submitting material to the docket, call Andrea M. Jenkins, Program Manager, Docket Operations, telephone 202–366–0271.

SUPPLEMENTARY INFORMATION:

I. Preamble Organization

This preamble is organized as follows:

Public Participation and Request for Comments

We encourage you to participate in this rulemaking by submitting comments and related materials. All comments received will be posted, without change, to *http://dms.dot.gov* and will include any personal information you have provided. We have an agreement with the Department of Transportation (DOT) to use the Docket Management Facility. Please see DOT's ''Privacy Act'' paragraph below.

Submitting comments: If you submit a comment, please include your name and address, identify the docket number for this rulemaking (USCG–2002–11288), indicate the specific section of this document to which each comment applies, and give the reason for each comment. You may submit your comments and material by electronic means, mail, fax, or delivery to the Docket Management Facility at the address under **ADDRESSES**; but please submit your comments and material by only one means. If you submit them by mail or delivery, submit them in an unbound format, no larger than 8½ by 11 inches, suitable for copying and electronic filing. If you submit them by mail and would like to know that they reached the Facility, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period. We may change this rule in view of them.

Viewing comments and documents: To view comments, as well as documents mentioned in this preamble as being available in the docket, go to *http://dms.dot.gov* at any time and conduct a simple search using the docket number. You may also visit the Docket Management Facility in room PL–401 on the Plaza level of the Nassif Building, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

Privacy Act: Anyone can search the electronic form of all comments received into any of our dockets by the name of the individual submitting the comment (or signing the comment, if submitted on behalf of an association, business, labor union, etc.). You may review the Department of Transportation's Privacy Act Statement in the **Federal Register** published on

April 11, 2000 (65 FR 19477), or you may visit *http://dms.dot.gov.*

Public Meeting

We do not now plan to hold a public meeting. But you may submit a request for one to the Docket Management Facility at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that one would aid this rulemaking, we will hold one at a time and place announced by a later notice in the **Federal Register**.

Program History

The U.S. waters of the Great Lakes and St. Lawrence Seaway to Snell Lock is divided into three pilotage districts which are further divided into Areas. Each district is administered by an Association (any organization that holds or held a Certificate of Authorization issued by the Director of Great Lakes Pilotage to operate a pilotage pool on the Great Lakes). District One, which contains Areas 1 and 2, includes all U.S. waters of the St. Lawrence River between the international boundary at St. Regis and a line at the head of the river running (at approximately 127° True) between Carruthers Point Light and South Side Light extended to the New York shore. District Two, containing Areas 4 and 5, includes all U.S. waters of Lake Erie westward of a line running (at approximately 026° True) from Sandusky Pierhead Light at Cedar Point to Southeast Shoal Light; all waters contained within the arc of a circle of one mile radius eastward of Sandusky Pierhead Light; the Detroit River; Lake St. Clair; the St. Clair River, and northern approaches thereto south of latitude 43°05′30″ N. District Three, containing Areas 6, 7, and 8, includes all U.S. waters of the St. Mary's River, Sault Ste. Marie Locks and approaches thereto between latitude 45°59′ N at the southern approach and longitude 84°33′ W at the northern approach.

The Great Lakes Pilotage Act of 1960 requires foreign flag vessels and U.S. flag vessels in foreign trade to use a federal Great Lakes Registered Pilot while transiting the St. Lawrence Seaway and the Great Lakes system. 46 U.S.C. Chapter 93. The Coast Guard is responsible for administering this pilotage program, which includes setting rates for pilotage service.

The Coast Guard pilotage regulations require annual reviews of pilotage rates and the creation of a new rate at least once every five years, or sooner, if the annual review shows a need. 49 CFR part 404. In order to facilitate this process, each pilot association must provide annual financial reports to the Coast Guard. The Coast Guard contract accountant uses these reports, in connection with annual reviews of each association's records, to prepare independent financial reports. The Coast Guard uses these reports in its annual evaluation of whether a rate adjustment is necessary and appropriate.

The last full-rate adjustment became effective in August 2001, and a partial-rate adjustment became effective on January 12, 2004. The 2004 partial-rate adjustment was based on calculations using 2001 financial data.

The rates in this interim rule are based on data from the ''Independent Accountant's Reports on Applying Agreed Upon Procedures, Financial Statement Analysis, Supplementary Financial Information and Report of Findings and Recommendations 31 December 2002'' for each District and the 2003 AMO union contracts. The Coast Guard followed the ratemaking analyses and methodology in 46 CFR part 404 and Appendix A to that part.

To determine whether projected traffic under the current rate structure is adequate to raise enough revenue to cover all costs and permit the pilots to earn target pilot compensation, the rate-setting methodology looks at projected and target pilot compensation, necessary and reasonable operating expenses, return on investment, and revenue projections. (Target pilot compensation is set based on the American Maritime Officers' (AMO) union contract.)

The last full-rate adjustment became effective August 13, 2001. On January 23, 2003, the Coast Guard published a notice of proposed rulemaking (NPRM) using 2001 financial information. 68 FR 3202. That NPRM recommended a 25 percent average increase in pilotage rates. This recommended increase was based on a number of factors, including an approximately 20 percent increase in the AMO union contract, an adjustment for inflation, and other increased costs. The public was afforded many opportunities to comment—there were two public meetings and an extended comment period.

The Coast Guard got comments from the pilots, the Great Lakes maritime community, and other agencies that raised issues that had not been addressed by the Coast Guard in earlier ratemakings. These comments included the impact of pilotage rates on foreign flag shipping in the Great Lakes, the method for calculating components of the rate multiplier, target pilot compensation, and projection of revenues and expenses.

In response, the Coast Guard issued an interim rule that established a partial rate adjustment of five percent to implement the uncontested parts of the rate increase in time for the 2004 season, and allow the Coast Guard time to evaluate the remaining open issues. 68 FR 69564, Dec. 12, 2003. Corrections to this interim rule were published the following January. 69 FR 128, Jan. 2, 2004, and 69 FR 533, Jan. 6, 2004.

This interim rule will resolve the remaining rate calculation issues raised by the January 2003 NPRM. We will calculate a full rate adjustment using the methodology in 46 CFR part 404.

The rates in this interim rule are based on data from the ''Independent Accountant's Reports on Applying Agreed Upon Procedures, Financial Statement Analysis, Supplementary Financial Information and Report of Findings and Recommendations 31 December 2002'' for each District and the 2003 AMO union contracts. The Coast Guard followed the ratemaking analyses and methodology in 46 CFR part 404 and Appendix A to that part.

Discussion of Comments

Significant rules often require additional staffing and review of each document in the rulemaking process. The Coast Guard's plan to issue an SNPRM, provide time for public comment, and then issue the rate change cannot be completed before the end of the 2004 navigation season. Because of the amount of time already consumed in developing this full-rate calculation and to ensure that a new rate is not delayed beyond the start of the 2005 navigation season, the Coast Guard has decided to issue the full-rate calculation as an interim rule with an effective date just before the start of the 2005 navigation season. Issuing an interim rule will allow us to receive and evaluate comments and make any necessary changes, while at the same time, allow the new rates to become effective in time for the 2005 season.

General

The Coast Guard received 27 comments in response to the December 2003 interim rule. Many of these comments expressed concerns about the calculations done for the partial-rate adjustment in the interim rule; about what expenses were allowed; and about the monthly multiplier used to calculate the target pilot compensation. We received comments from individual pilots, pilots' Associations, and from the Great Lakes Pilotage User Group, which includes the Shipping Federation of Canada and its members, the U.S. Great Lakes Shipping Association, the Chamber of Maritime Commerce, and the American Great Lakes Ports Association, Inc.

To the extent that NPRM comments have previously been addressed in the December 2003 IR, no further responses have been made to comments in the NPRM. However, certain issues raised in the NPRM, were deferred in the IR for further review and response in SNPRM/IR. Those issues have been included in preamble of this document.

Significance

Issue: We received several comments on the Coast Guard's determination that this rulemaking was not significant under Executive Order 12866. Three comments expressed agreement with the determination of ''not significant'' but stated the rule ''would have a substantial impact on the type and quality of pilotage services'' and ''* * * the pilots concur with the decision in the interim rate notice of the Coast Guard, the Department of Homeland Security, and the Office of Management and Budget that this proposed rate adjustment is not significant under section 3(f) of Executive Order 12866. (68 FR 69568).'' Similarly, the pilots concurred with the statement in the NPRM that, ''[w]hile these adjustments to pilotage rates may seem relatively large they actually represent a small change to the overall cost of moving these vessels through the St. Lawrence Seaway System.'' (68 FR 3213).

One comment, disagreeing with the ''not significant'' determination, repeated from its earlier comments that the proposed rate increase was a ''significant regulatory action,'' under Executive Order 12866 and thus requires an economic analysis of its impact.

Response: Although this rulemaking is not economically significant under Executive Order 12866, OMB has determined that it is a significant rulemaking action and has reviewed it under that Order.

The Coast Guard contracted for an economic analysis of rate changes for pilotage on the Great Lakes and it is available for review in the docket. An analysis of the changes in this interim rule is set out in the Regulatory Evaluation of this preamble.

Immediate Rate Implementation

Issue: In the 2003 interim rule, we said we planned to publish a supplemental notice of proposed rulemaking (SNPRM) with an opportunity to comment before effecting a permanent rate adjustment during the Spring 2004. Numerous comments urged the Coast Guard to issue new pilotage rates as an interim rule, effective immediately. One comment stated that the pilotage pools are working on an expense base that is nearly a decade old. Another comment said that the last rate adjustment in pilotage rates for the Great Lakes went into effect in August 2001. The comment further stated that ''it has been almost three years since those rates have been adjusted, even though Federal regulations require the Coast Guard to perform an annual review and adjustment of the rates.'' One comment stated this rate is long overdue and an interim final rule should be in place before the start of the 2004 navigation season.

Some comments urged the Coast Guard not to follow the December 12, 2003, interim rule with an SNPRM, stating that an SNPRM, which is not effective immediately, but rather subject to public comment, would delay the effective date of any further rule and serve no purpose except delay. Another comment stated the Coast Guard should issue the rate now as an interim final rule, effective immediately, while continuing to accept comments. One comment stated that a delay in the rate serves as a subsidy to foreign shipping companies, who have tripled their freight rates over the 2003 shipping season.

One comment stated that the ''most glaring point is that it is now the second month of 2004 and we are addressing these comments to a docket established in 2002 despite the fact that the Coast Guard is required to routinely review and establish pilotage rates on an annual basis. One of the purposes of an annual review is to adjust rates periodically on an incremental basis that avoids the impact and political fallout of large adjustments.''

One comment stated it is within the Coast Guard's administrative authority to issue this rate as an interim final rule, effective immediately, receive further comments, and later adjust the rule, if necessary.

Response: Although the NPRM and the 2003 interim rule were not ''significant'' under Executive Order 12866,this interim rule is ''significant.'' Significant rules often require additional staffing and review of each document in the rulemaking process. The Coast Guard's plan to issue an SNPRM, provide time for public comment, and then issue the rate change cannot be completed before the end of the 2004 navigation season. Because of the amount of time already consumed in developing this full-rate calculation and to ensure that a new rate is not delayed beyond the start of the 2005 navigation season, the Coast Guard has decided to issue the full-rate calculation as an interim rule with an effective date just before the start of the 2005 navigation season. The Coast Guard received comments on both the NPRM and 2003 interim rule. Issuing an interim rule will allow us to receive and evaluate additional comments and make any necessary changes before finalizing the rates, while at the same time, allowing the new rates to become effective in time for the 2005 season.

New Data for Calculation of Rate

Issue: Several comments urged the Office of Great Lakes Pilotage ''to issue an interim final rate using current rate and revenue figures for each of the three districts.''

One comment supported using updated data and believed it would result in a more accurate rate setting. However, the comment urged the Coast Guard ''to make the new data (including the AMO union contract and 2002 audits) available to the public and provide adequate time for comment.''

Another comment stated that the Coast Guard should use the most current figures available. The pilots asked that use of the most current figures not be used as a reason to recalculate, and, therefore, substantially delay the rate.

One comment also stated that ''U.S. laker mate and master compensation is currently more than 16 percent higher than target pilot compensation.'' The comment suggested that ''the Coast Guard mitigate this chronic inequity as much as possible by always using the latest available AMO union contract and the expense figures in every rate it enacts.''

Response: In calculating the proposed rate in the NPRM, and the partial rate in the interim rule, the Coast Guard used data from the 2002 AMO union contracts and the 2001 independent accountant's reports for each District. In the December 2003, interim rule, we said we were considering using the data from the 2003 AMO union contracts for our full-rate calculation. We also proposed using the most current (2002) expense and revenue figures from each of the three Districts for the full-rate calculation. We specifically requested comments on whether we should use the newer data to calculate the full-rate adjustment.

The comments on this issue supported using updated data because it would result in a more accurate rate setting, and requested that the new data be made available to the public with adequate time for comment. The Coast Guard agrees with this rationale.

In calculating this full-rate adjustment, the Coast Guard used the data from the 2003 AMO union contract and the 2002 independent accountant's reports for each District. These materials are available for review in the public docket.

Adjustment for Lost Revenue

Issue: One comment requested that an adjustment be added to this rate so that the pilots would be reimbursed for monies lost because this rate was not in effect at the beginning of the 2003 navigation season.

Response: Although the regulations provide for some adjustments during calculation of pilotage rates, those adjustments relate to correcting erroneous amounts and classifications of expenses and revenues; determining and using an inflation adjustment; and an adjustment mechanism for ''foreseeable circumstances.'' The type of adjustment suggested by the comment to recover monies for services prior to establishment of the new rate is not allowed by the current regulations. The Coast Guard has not included any adjustment for services provided by the pilots prior to the establishment of the new rate. The regulations do not provide for retroactive application of rates or prospective adjustments to fees paid by shippers or earned by pilots.

Expenses

General. The Coast Guard received comments concerning particular types of expense items. Some comments disagreed with the Coast Guard's reclassification of an expense as pilot compensation or disagreed with amounts which had been disallowed and removed from the expense base. These expense issues are discussed individually below.

Some comments related to particular expense items in previous rate calculations and reviews of Association financial statements. This section of the preamble does not discuss specific expense items incurred prior to those in the 2002 financial statements. We do, however, generally discuss various types of expenses and whether or not these expenses are normally recognized and allowed and how these types of expenses were treated in calculating this full-rate adjustment.

In determining whether expenses should be allowed, the Coast Guard applied the guidelines for recognition of expenses set out in 46 CFR 404.5(a)(1) and (a)(2). Under 46 CFR 404.5(a)(1), each expense item is evaluated to determine if it is necessary for the provision of pilotage service, and if so, what dollar amount is reasonable for that expense item. Criteria for determining reasonableness of expense items are set out in 46 CFR 404.5(a)(2), which requires that each expense item be measured against one or more of the following: Comparable or similar expenses paid by others in the maritime industry; comparable or similar expenses paid by other industries; or, U.S. Internal Revenue Service guidelines.

Source Documentation

Issue: Two comments stated that ''source documentation'' should be made available to the public so it can determine if the Coast Guard correctly applied the ratemaking analyses and methodology found in Appendix A to 46 CFR part 403 in the regulations. One comment asked that the amount and nature of legal expenses incurred by two Districts, as well as travel expenses and the amounts invoiced for services provided before August 13, 2001, for these Districts, be made public and available for comment before an SNPRM is published.

Response: The Coast Guard disagrees. Under 46 CFR 403.105(b), each Association is required to maintain ''all books, records and memoranda in a manner that will permit audit and examination by the Director or the Director's representatives.'' Section 403.105 does not require that individual source documents be submitted to the Coast Guard or made available to the public. However, any financial statements, data, and other materials the Coast Guard used in calculating the rate in this interim rule are in the docket for this rulemaking and are available for inspection and copying at the address and web site found in the **ADDRESSES** section.

Legal Fees

Issue: In response to the December 2003, interim rule, one comment stated the Coast Guard must establish a methodology for determining the appropriate amount of legal fees to justify inclusion of such fees into the expense base.

Response: The Coast Guard disagrees. Legal fees necessary for the provision of pilotage in reasonable amounts for the expense items submitted are allowed if they are substantiated as set out in 46 CFR 404.5. In 2002, all legal fees submitted as expenses were recognized and allowed.

Non-Recurring Expenses

Issue: In the interim rule, the Coast Guard discussed recurring and non-recurring expenses in conjunction with Erie Leasing Inc., and said it would review those issues before calculating a full-rate adjustment.

Response: It has done so. Erie Leasing Inc., was an affiliate company owned by the Lakes Pilot Association in District Two. It provided support services to the pilot association through its rental and leasing of pilot boats, automobiles, and office space. Erie Leasing Inc., no longer exists. It was dissolved in 2001 and its assets were sold off. Since District Two has divested itself of Erie Leasing and because we used the 2002 financial data, there are no leasing expense issues in the current calculation.

Issue: One comment stated that only recurring expenses should be included in the expense base. Another comment stated that ''including non-recurring costs will artificially inflate rates for pilotage services * * * and that the Coast Guard must perform the critical analysis to assure the segregation of those costs from the expense base.'' Another comment stated that the Coast Guard should remove non-recurring legal expenses from the expense base.

Response: Pilot Associations may incur unusually large expenses in a single year which will not recur in subsequent years. These expenses may be related to leasing of pilot boats or to the cost of operation or maintenance of purchased pilot boats, or to legal fees related to litigation, or other occasional expenses. All expenses, recurring and non-recurring, are subject to the same criteria in 46 CFR 404.5.

In these cases, the regulations do not prohibit the inclusion of non-recurring expenses in the expense base. Any expense, recurring or non-recurring, if recognized as necessary for the provision of pilotage services, and if reasonable in amount, is an allowable item in the expense base.

Lobbying Expenses

Issue: One comment asserted that the Coast Guard had not removed all lobbying expenses from the expense base used in the partial-rate calculation.

Response: This comment is incorrect. Under 46 CFR 404.5(a)(8)(ii), lobbying expenses are one of five specific expenses that are not recognized as expenses for ratemaking purposes. In the 2002 expense base submissions used in this calculation, the lobbying expenses for Districts One and Three were removed from their legal fee expense item. District Two confirmed that they had no lobbying expenses in 2002.

Subsistence Payments

Issue: One comment said the Coast Guard, ''needs to allow subsistence expenses in the rate base'' and since they provided the Office of Great Lakes Pilotage documentation in the form of source forms and dispatch sheets, that the full amount should be allowed in the expense base.

One comment said pilots should be allowed subsistence based on the number of days worked which the District does substantiate as to time, place, and purpose (dispatching forms and source forms are submitted to the Director on a monthly basis). Further, the comment stated this methodology is acceptable for IRS purposes. IRS Rev. Proc. 2002–63. Sec. 3.03 states, ''[s]uch allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee * * *.'' The subsistence payments are paid separately and clearly identified as such. In addition, the Association can provide substantiation as to time, place, and purpose.

Response: Subsistence expenses are already accounted for, either directly or indirectly. For 2002, in District One, subsistence (per diem and travel) was reimbursed based upon adequately prepared and documented contemporaneous log entries and reported on a per trip basis. Any amount over $75 was documented as required by IRS Code requirements for substantiation of travel-related expenses. All District One travel expenses were allowed.

District Two paid their pilots a daily meals and incidental expense allowance of $38 per day, based on days available, approximately 265 days per pilot. This amount was not a reimbursement for expenses actually incurred and was disallowed because the Department of Transportation guidance incorporating the Federal Travel Regulations in 41 CFR part 301–11 do not permit payments based on days available for travel. Internal Revenue Service Regulations 1.62–2(c) and Rev. Proc. 2001–47 allow for ''reasonable business practice'' in reimbursement of per diem costs. Using Federal Travel Regulations' established allowances for Transportation workers daily meals and expenses in 41 CFR part 301–11, the per diem allowance was recalculated allowing per diem for each pilot for 200 travel days, which included days engaged in pilotage, travel between assignments, and down time at remote locations awaiting dispatch. The 200 days was based on the number of days worked according to a schedule provided by the Association.

In District Three, the pilots reported their per diem expenses to the Association but did not get reimbursed for them directly. Instead, pilot per diem was calculated according to a schedule provided by the Association, using the number of days worked. This per diem allowance approximated 200 travel days per pilot. Temporarily registered pilots were paid a per diem allowance. All pilots were reimbursed for actual hotel and temporary lodging expenses.

Travel Expenses

Issue: One comment objected to the Coast Guard reclassifying $8,600 of travel expense as pilot compensation. The comments stated these amounts represented reimbursement to pilots for attendance at board of directors meetings as well as meetings regarding other District Two business (insurance, etc.) and were reimbursements for travel expense and not compensation to the pilots.

Response: Under IRS regulation 1.62–2(c)(5), reimbursement for travel costs that are not regularly reported as expenses to employers (a non-accountable plan) are fully taxable to the employee and subject to FICA and income tax withholding. The $8,600 travel expense relates to an adjustment made to District Two's financial position as noted in the 2003 interim rule. District Two reported a travel expense of $8,600, which was reclassified as pilot compensation. These amounts represented unaccounted for payments by the Association to pilots for attendance at board of directors meetings as well as other District Two business meetings. In this case, pilots were given cash to conduct their travel without a requirement to account for the use of the money or to repay amounts not expended in connection with business. Accordingly, these amounts were properly considered compensation and not expenses.

With respect to the 2002 financial reports, the Coast Guard adjusted and reclassified travel expenses reported by District One and District Three. In District One, $10,500, and in District Three, $146,907, in pilot travel expenses, were reclassified as operating expenses from pilot compensation.

Business Promotions

Issue: One comment stated the Director, Great Lakes Pilotage, incorrectly disallowed a 2001 business promotion expense of $74 as unrelated to the provision of pilotage services. District Two provides services in addition to pilotage to lakers (vessels that operate entirely within the Great Lakes system). The revenue from lakers was $8,126 for 2001. District Two advertises and promotes this service as a means of generating revenue to offset total boat expenses.

Response: The Coast Guard disagrees. Although the comment related to 2001 expenses, the 2002 independent accountant's report disallowed similar expenses and the Coast Guard adopted the recommendation. The regulations in § 404.5(a)(5) state that, ''[f]or ratemaking purposes, the revenues and expenses generated from Association transactions that are not directly related to the provision of pilotage services are included in ratemaking calculations as long as the revenues exceed the expenses from these transactions.'' However, the promotional advertisement did not advertise the specific service to be provided, but rather contained only the name of the Association. The business promotion expenses were not specifically related to offering services other than pilotage, but were incurred generally to create goodwill in the community; therefore, the expenses will not be recognized.

Health Insurance Premiums for Retired Pilots

Issue: One comment stated that the Office of Great Lakes Pilotage needs to continue to allow health insurance paid to two individual retired pilots in the expense base.

Response: Under 46 CFR 404.5(a)(6), medical, pension, and other benefits paid to pilots, or for the benefit of pilots, by the Association are treated as pilot compensation. The amount recognized for each of these benefits is the cost of these benefits in the most recent AMO union contract for first mates on Great Lakes vessels. The AMO union contract has been used since the ratemaking methodology was amended effective June 12, 1995. The AMO union contract was used in the 1997 and 2001 final rulemaking and the 2003 interim rule. The AMO union contract also represents most first mates and masters working on the Great Lakes. To remain consistent, we will continue to use the AMO union contracts as the basis in our calculations of target pilot compensation. That contract allows for lifetime health insurance for all active and retired first mates, and the cost of health insurance for retired pilots is not otherwise provided for as ''target compensation'' in the calculated compensation base. Therefore, these costs are properly included in the expense base. In District Two, $19,494 for health insurance for retirees was added to the expense base from pilot compensation.

Accounts Receivable

Issue: One comment asked whether accounts receivable should be included in the revenue base.

Response: Accounts receivable is included in revenue on the accrual basis of accounting when calculating the revenue base. All three Districts use the accrual system, including accounts receivable in the revenue base in accordance with generally acceptable accounting principles.

Pilotage Dues

Issue: One comment stated that only 15 percent of the American Pilots Association dues expense should have been disallowed for lobbying in 2001, and that 85 percent of the dues amount should have been added back into the expense base for District Two. The comment stated, ''it is absolutely necessary that pilots belong to professional organizations which keep them informed of current changes in the pilotage industry. This is not compensation to the pilots. These dues are reasonable and proper business expenses.''

Response: All of the American Pilots Association dues expenses were not prohibited as lobbying expenses; they were reclassified as pilot compensation. American Pilots Association dues are not an expense. Union pilots who work for domestic shipping companies must pay their own dues and the amounts paid by the pilotage organizations for the benefit of pilots have been correctly reclassified as pilot compensation, the use of which to pay dues is discretionary and personal to the pilots.

As set out in 46 CFR 404.5(a)(6), medical, pension, and other benefits paid to pilots, or for the benefit of pilots, are treated as pilot compensation. Because union dues are ''other benefits,'' they have been consistently treated as such and have, therefore, been properly classified as compensation. No provision for the payment of union dues by employers is provided for in the current AMO union contract. The allowability of the lobbying expense portion of the dues is therefore not an issue.

In this computation, pilotage dues of $26,210 and $6,600 from District Three; $15,840 from District Two; and $13,970 from District One were all removed from the expense base and reclassified as pilot compensation.

Investment Base

Issue: One comment said the target return on investment should be increased from 0.0704 to a ''realistic'' number, which is probably more than double this figure.

Another comment stated that, ''in the rate methodology, we find it difficult to accept that investment in assets necessary to provide pilotage services is recognized only at a rate of return on investment equivalent to high quality bonds. High quality bonds are a safe, passive investment requiring no management or risk. That is not the case in the pilotage environment in the Great Lakes or in any other area.''

A third comment said, ''we believe a fair return on pilot assets would be a minimum of 15 percent to recognize lost opportunity costs from alternative available investments for their financial assets.''

One comment stated that wrong numbers were used for the investment base's return on investment for one of the Districts. The comment also stated the return on investment should be more than double the 0.0704 used in the interim rule.

Response: In calculating the investment base for 2002, we are required to use the Investment Base Formula in Appendix B to 46 CFR part 404. We must calcualate the investment base to project each association return on investment pursuant to 46 CFR part 404, Appendix A, Step 4. Under step 5(2) of Appendix A, it states that, ''the allowed Return on Investment (ROI) is based on the preceding year's average annual rate of return for new issues of high grade corporate securities.'' We have used Moody's AAA bond rate for this purpose since the methodology was adopted in 1995. Moody's Corporation is a publicly traded company (NYSE:MCO) that provides financial services, including credit ratings, research, and risk analysis.

The investment base reported by each District for 2002, and reviewed by the independent accountant, was incorporated into the independent accountant's report for each District without adjustment. These amounts were used for the projection of return on investment and in the calculation of this rate.

Inflation Rate

Issue: One comment stated the inflation rate for the full-rate adjustment should be increased to five or six percent instead of the two percent found in the interim rule.

Response: Appendix A to 46 CFR part 404, Step 1.C., ''Adjustment for Inflation or Deflation,'' requires an inflation adjustment for which we used the preceding year's change in the U.S. Department of Labor, Bureau of Labor Statistics, ''Midwest Economy—Consumer Prices.'' This is a separate adjustment to expenses and is in addition to inflation adjustments to the union contract. The ''Midwest Economy—Consumer Prices'' index of the North Central Region has been traditionally used as part of the ratemaking methodology and it most accurately reflects economic changes over time in the Great Lakes region. When, as here, several years elapse between rate adjustments, the inflation rate will be compounded, that is, the adjustments become cumulative. In this ratemaking, we are using an inflation adjustment of 1.9 percent for each of the years 2003 and 2004 to properly account for inflation from the date of the last full ratemaking in 2001.

401(k) Plans

Issue: Three comments discussed whether 2001 contributions to employee 401(k) plans were calculated correctly and how much an employer is allowed to contribute to those 401(k) plans. Of those, one comment said employer contributions to those 401(k) plans had been improperly calculated—that it should be based on a first mate's daily pay. Another comment stated that the Coast Guard had correctly calculated the employer portion by using a first mate's total pay, instead of just their daily pay. Another comment said that all three Districts should be allowed to add expenses for contributions, not just two of them (Districts Two and Three).

Response: As of August 1, 2001, the AMO union contracts required employers to match employee contributions to a 401(k) plan in an amount equal to 42 percent of the employee contribution up to 4.2 percent of the employee's compensation. Effective August 1, 2002, the matching amount was increased to 50 percent not to exceed 5 percent of employee compensation.

In direct response to the three comments, the Coast Guard, consistent with prior years' calculations, has used the AMO union contracts for the purposes of computing employer contributions to 401(k) plans, we have consistently used the AMO union contracts' definition of ''compensation'' of a contributing employee—''the pilots' wages for time worked, not including benefits.'' We have included in total pilot compensation an amount for the first four months equal to 42 percent of the pilot's contribution up to 4.2 percent of a contributing pilot's base wages and for the next five months, a 50 percent employer match up to 5 percent of a contributing pilot's base wages. This amount is included as a benefit in total pilot compensation.

Number of Pilots Needed

Issue: A number of comments criticized the Coast Guard's determination of the number of pilots needed to provide pilotage services for the projected volume of vessel traffic. One comment said that the result of not rounding up the number of pilots needed in each area separately will be to under-staff each area and delay the ships.

Response: In the interim rule, we divided the individual bridge-hour target per pilot (1,000 or 1,800 hours required by 46 CFR part 404, Appendix A, Step 2B (1) and (2)) into projected bridge hours in each area to determine the ''number of pilots needed'' in each area. That number is almost never a whole number in any calculation. In the partial-rate calculation, we did not round up to the ''next whole number'' because to do so would inaccurately inflate the resulting target pilot compensation and revenues needed. This number is merely one step in the calculation of the rate. It should not be confused with the actual number of pilots employed in each area to provide necessary pilotage services.

In this full-rate calculation, again for precision and accuracy in computation, we calculated the ''number of pilots needed'' in each area to the nearest tenth. We did not round up or down to the nearest whole number. As we stated in the interim rule, it is up to each Association to determine how many pilots to employ to meet the actual shipping demand.

Delay and Detention

Issue: A number of comments stated that the Coast Guard needs to include detention, delay, and travel time in the calculation of bridge hours.

One comment stated American Great Lakes pilots have always counted delay, detention, movages, and cancellations (DDMC) when calculating bridge hours. Canadian pilots count DDMC as bridge time. Pilots throughout the United States count DDMC as bridge time. Delay and detention figures have always been included in past rate adjustments.

Other comments said the Coast Guard has excluded delay and detention from projected bridge hours. One comment stated ''prior to the 2000 rate, detention and delay was always included in projected bridge hours, and the exclusion of detention and delay from projected bridge hours was strictly the erroneous interpretation of the previous Director of Great Lakes Pilotage.''

Response: The Coast Guard disagrees that it has improperly calculated bridge hours. In this ratemaking, bridge hours are determined based upon the same definition that has appeared in the regulations since 1995, when the ratemaking methodology was published. 60 FR 18366, April 11, 1995. That definition appears at Appendix A to 46 CFR part 404 in (Step 2.B.(1)), ''Determination of Number of Pilots Needed,'' and states that ''Bridge hours are the number of hours a pilot is aboard a vessel providing basic pilotage service.'' The Coast Guard continues to interpret this language to mean actually providing pilotage service and not to include delay, detention, and travel time. The Coast Guard's interpretation of bridge hours will be reviewed in light of the ''Bridge Hour Study'' conducted by RADM Riker USCG Ret. That review may result in a separate rulemaking to revise the ratemaking analyses and methodology.

Target Pilot Compensation

The 54-Day Multiplier

Issue: There were numerous comments to the interim rule that opposed the use of 44 days as the multiplier when calculating target pilot compensation. One comment expressed concern that the use of the 44-day multiplier in the interim rule was a proposed change that would be carried forward into future rulemaking. Another comment objected to the multiplier being reduced from 54 to 44 days on the basis of pilots having scheduled time off during the season, with no corresponding decrease in bridge hours during the navigation season.

Still another comment stated the Coast Guard must re-think its calculation of target compensation and reinstate the 54-day basis for target compensation to reflect the fact that revenue generation is based on the average annual compensation of first mates and masters of lake ships. One comment stated it was a ''profound'' error to change the multiplier from 54 days to 44 days because it reduced the calculation of target pilot compensation by 15.27 percent in undesignated waters and 16.16 percent in designated waters with no corresponding reduction in the work standard (1,800 and 1,000 hours, respectively).

Response: In the 2003 interim rule, the Coast Guard used a 44-day multiplier to calculate the partial-rate adjustment. The use of the 44-day multiplier was a one-time use of that number solely for the purposes of the partial-rate calculation. The interim rule did not propose a permanent change to the multiplier. The reason we used the 44 days was because of comments on the NPRM suggesting a reduction in the multiplier from 54 to 44 or 45 days, to take into consideration vacation time actually taken by the pilots.

As stated in the interim rule, the Coast Guard used 44 days as the multiplier while it reviewed the multiplier issue and made a final determination on the appropriate multiplier to use in the full-rate calculation. The use of 44 days in the interim rule was not a change to the methodology, but rather the highest number we were certain of before we completed the review of this issue. We have completed that review. We have concluded that 54 days is the correct multiplier, and have used that number in this full-rate calculation.

This is consistent with the current AMO union contract under which a first mate who works a full month will receive wages, exclusive of benefits, equivalent to 54 times the daily wage rate.

We have historically used the 54-day multiplier used by AMO in their contracts. Under the AMO contracts, this 54-day multiplier is broken down as follows:

Average Working Days per Month ...	30.5
Vacation Days per month	15.0
Weekend Days per month	4.0
Holidays per month	1.5
Bonus per month	3.0
	54.0
Basic Calculation	*

*54.0 × Daily Rate = Monthly Wage Rate.

The purpose of the Coast Guard's ratemaking methodology is to ensure that a pilot working 1,800 hours on undesignated waters receives the average annual compensation for first mates on U.S. Great Lakes vessels based on the most current AMO union contracts and that a pilot working 1,000 hours on designated waters receives the average annual compensation of masters on U.S. Great Lakes vessels. We believe that use of the 54-day multiplier to calculate wages in conjunction with our historic methodology of calculating benefits best meets this purpose.

Discussion of the Rule

Ratemaking Process and Methodology

This section is a description of the analyses performed, and the seven-step methodology followed, in the development of the full-rate adjustment. The first part summarizes the full-rate changes in this interim rule. The second part describes the ratemaking process and explains the formulas used in the methodology to show how the full-rate adjustment was actually calculated.

The authority to establish pilotage rates on the Great Lakes derives from 46

U.S.C. 9303(f), which states, in pertinent part, that: ''[t]he Secretary shall prescribe by regulation rates and charges for pilotage services, giving consideration to the public interest and the costs of providing the services.''

The pilotage regulations require that pilotage rates be reviewed annually in accordance with procedures detailed in Appendix C to 46 CFR part 404. The Coast Guard reviews Association financial reports annually and, at a minimum, the Coast Guard completes a thorough review of pilot association expenses, and establishes pilotage rates in accordance with the procedures detailed in § 404.10 and Appendix A of this part at least once every five years. If the annual review shows that pilotage rates are within a reasonable range of their target, no adjustment to the rates will be initiated. However, if the annual review indicates that an adjustment is necessary, or if it is the fifth anniversary of the last full ratemaking, then the Coast Guard will establish new pilotage rates using § 404.10 and Appendix A of this part.

The Coast Guard compares projected rates of return on investment to target rates of return on investment for each pilotage area to determine whether an adjustment to the pilotage rates is necessary. If the projected rates of return on investment are lower than the target rates of return on investment, the revenues generated by the current pilotage rates would be insufficient for the pilots to earn target pilot compensation. As the following analysis shows, the difference between the projected rates of return on investment and the target rates of return on investment, makes an increase appropriate in this case. Therefore, the Coast Guard used the methodology contained in Appendix A to develop a new rate. The purpose of the ratemaking analyses and methodology contained in Appendix A is to arrive at a rate multiplier that will make the projected rates of return on investment equal to the target rates of return on investment in each pilotage Area. Once this is accomplished, the Coast Guard calculates a rate multiplier, that when applied to the current rates will increase or decrease those rates, generating sufficient revenue to permit the pilots to earn target compensation.

To arrive at the rate multiplier, the Coast Guard first projects target pilot compensation, revenue, and reasonable and necessary pilot expenses. In a separate calculation, the Coast Guard then calculates the investment base for each District to determine the target rate of return on investment. Taking into consideration revenues, expenses, and returns on investment, the Coast Guard then calculates the projected rates of return on investment. The Coast Guard then compares the projected rates of return on investment to the target rates of return on investment. If there is a difference between the projected rates of return on investment and target rates of return on investment, a rate adjustment may be appropriate. Finally, to arrive at the appropriate rate multiplier, the revenue needed is divided into projected revenue. A rate multiplier is calculated individually for each Area. The new rates are arrived at by multiplying the rate in each Area by the applicable rate multiplier.

Part 1: Pilotage Rate Charges—Summarized

The pilotage rates for Federal pilots on the Great Lakes contained in 46 CFR 401.405, 401.407, and 401.410 have been adjusted in accordance with the methodology appearing at 46 CFR part 404. The full-rate adjustment results in an average increase of 20 percent across all Districts over the partial-rate adjustment.

2004 AREA RATE CHANGES

[In percent]

If pilotage service is required in:	Then the rate represents a change over the current rate of:
Area 1 (Designated waters)	20
Area 2 (Undesignated waters)	16
Area 4 (Undesignated waters)	26
Area 5 (Designated waters)	29
Area 6 (Undesignated waters)	16
Area 7 (Designated waters)	16
Area 8 (Undesignated waters)	13

Rates for ''Cancellation, delay or interruption in rendering services (§ 401.420)'' and ''Basic rates and charges for carrying a U.S. pilot beyond [the] normal change point, or for boarding at other than the normal boarding point (§ 401.428)'' are increased by 20 percent. These charges are the same in every Area.

Part 2: Calculating the Rate Multiplier

The ratemaking analyses and methodology contained in Appendix A to part 404 is comprised of seven steps. These steps are:

(1) Projection of Operating Expenses;
(2) Projection of Target Pilot Compensation;
(3) Projection of Revenue;
(4) Calculation of Investment Base;
(5) Determination of Target Rate of Return on Investment;
(6) Adjustment Determination (Revenue Needed); and
(7) Adjustment of Pilotage Rates.

The data used to calculate each of the seven steps comes from the 2002 independent accountant's reports for each District. The Coast Guard also used the most recent union contracts between the AMO and vessel owners and operators on the Great Lakes to determine target pilot compensation. All documents and records used in this full-rate calculation have been placed in the public docket for this rulemaking and are available for review at the addresses under **ADDRESSES.**

The Coast Guard uses the Appendix A analyses and methodology to develop a rate multiplier to adjust pilotage rates in each pilotage Area. The following is an explanation of each step of the analyses and methodology and how the rate multiplier is calculated.

Some values may not total due to format rounding for presentation in charts and explanations in this section. The rounding does not effect the integrity or truncate the real value of all calculations in the ratemaking methodology described below.

Step 1: Projection of Operating Expenses

The Coast Guard projects the amount of vessel traffic annually. Based on that projection, the Coast Guard forecasts the amount of fair and reasonable operating expenses that pilotage rates should recover.

To project operating expenses, the Coast Guard obtains financial data from each Association. Included in the financial data is a detailed listing of all the Association's operating expenses. Based on recommendations of an independent accountant, the Coast Guard determines the expenses to be used in projecting future expenses. Once these expenses are identified and totaled, the Coast Guard makes an adjustment to the total for inflation or deflation. The Coast Guard then uses the projected annual vessel traffic to project the amount of expenses that the rates should recover.

The steps that follow explain how this is performed:

- Submission of financial information from each Association;
- Determination of recognizable expenses;
- Adjustment for inflation or deflation; and
- Final projection of operating expenses.

Submission of Financial Information

(1) Each district Association must provide the Coast Guard with detailed annual financial statements in accordance with 46 CFR 404.300.

This information is reviewed by a Coast Guard-contracted independent accounting firm. With this information, the independent accounting firm visits the offices of each Association and performs a detailed review of all accounts over $75 to confirm the accuracy of the financial statements provided by each Association. Using the financial statements from the Associations and the information obtained during the independent accounting firm's review of each Association's records and accounts, the independent accountant compiles this information into financial reports for each District.

(2) This interim rule uses the 2002 independent accountant?s reports for each District for the period ending December 31, 2002. These reports may be found in the docket.

Determination of Recognized Expenses

(1) The Coast Guard determines which Association expenses will be recognized for ratemaking purposes, using the guidelines for the recognition of expenses contained in § 404.5. Each Association is responsible for making available to the Coast Guard documentation to support the expense figures.

(2) Expense items which the Coast Guard determines to be necessary and reasonable for the provision of pilotage service are recognized for ratemaking purposes.

(3) The following is a summary of the adjustments to expense items adopted from the 2002 independent accountant?s reports ending on December 31, 2002.

	District one	District two	District three
SUMMARY OF EXPENSE ADJUSTMENTS			
1. Reported Expenses for 2002	$658,913	$1,295,595	$1,242,847
2. Expense Adjustments			
Social Security and Medicare Expenses	69,025	....	136,390
Reimbursed Expenses:			
Dispatch Service/Parking Fees	....	(76,671)	....
Pilot Boat Revenue	....	(290,508)	....
Canadian Pilot Revenue	....	....	(161,680)
Uncollected Pilotage Fees/Bad Debt Expense	....	....	14,190
Not Recognized Expenses:			
Lobbying Expenses	(21,000)	....	(9,000)
Promotional Expenses	....	(882)	....
Promotional/Charitable Expenses	....	....	(471)
Reclassified Expenses:			
As additional pilot compensation:			
Training Expenses (Paid to members for the training of unregistered pilots)	(2,500)	....	....
American Pilots Association (APA) dues	(13,970)	(15,840)	....
Contract Pilotage Fees as operating expense	(118,919)	....	....
Meeting attendance	....	(9,300)	(26,210)
APA/Masters, Mates, & Pilots dues	....	....	(6,600)
As operating expenses:			
Insurance Fees	23,578	....	....
Unreimbursed Travel Costs	12,076	....	....
Pilot travel expense (Reclassified as operating expense from pilots' compensation)	10,500	....	146,907
Undocumented Expenses:			
Subsistence (Daily meals/incidental expense per diem)	....	(17,180)	....
3. Total Adjustments	(41,210)	(410,381)	93,526
Total Adjusted Expenses for 2002	617,703	885,214	1,336,373
SUMMARY OF PROJECTION OF OPERATING EXPENSES			
1. Reported Expenses for 2002	658,913	1,295,595	1,242,847
Total Adjustments	(41,210)	(410,381)	93,526
Total Adjusted Expenses for 2002	617,703	885,214	1,336,373
2. Inflation Adjustments			
(2003)—1.9%	11,736	16,819	25,391
(2004)—1.9%	11,959	17,139	25,874
3. 2002 Adjustments for Foreseeable Circumstances	0	0	0
Expenses projections of $8,086 are for travel and FICA expenses associated with additional bridge hours projected for Area 2	8,086	....	....
4. Total Expenses for 2002 Pilotage. Expenses Projected for 2004	649,485	919,172	1,387,638

Each expense adjustment adopted by the Coast Guard on the independent accountant's recommendation is detailed and explained below, and in the notes to the 2002 independent accountant's reports for each District.

Adjustments made to reported expenses are divided into five categories:

(1) Social Security and Medicare Expenses;
(2) Reimbursed Expenses;
(3) Not Recognized Expenses;
(4) Reclassified Expenses; and
(5) Undocumented Expenses.

Social Security and Medicare Expenses

The Coast Guard must ensure that each Association's expenses are analyzed fairly and consistently with the other Associations. The Associations of Districts One and Three are organized as partnerships, while the Association of District Two is organized as a corporation. Because of this difference, the District Two Association pays the employer's share of Social Security and Medicare taxes out of corporate funds. In the Associations of Districts One and Three, the individual pilots pay these expenses because each pilot is self-employed. The Coast Guard adopted the recommendation of the independent accountant and amounts for these expenses have been added to District One and Three's expense bases. In District One, $69,025 in Social Security and Medicare taxes have been added to the expense base. In District Three, $136,390 in Social Security and Medicare taxes have been added to the expense base.

Reimbursed Expenses

The independent accountant found that a number of expenses have been erroneously reimbursed to the Associations and recommended that these expenses should not be included in each District's expense base. Examples are reimbursement from one pilots' Association to another for shared pilot boats and dispatch and reimbursement from Canadian pilots for shared administrative expenses, dispatch, and pilot boat services.

The Coast Guard adopted the independent accountant's recommendation to deduct these reimbursed expenses from the Districts' expense bases. These expenses are paid for by other Districts or parties, not by the Associations claiming them, and, as such, should not be included in the expense base of the District being reimbursed. In District Two, we deducted a total of $367,179 from the expense base—$290,508 from pilot boat revenue, of which $129,162 was for pilot boat surcharges from shippers, and $76,671 for dispatch service and parking fees. Likewise, in District Three, we deducted $161,680 in reimbursed expenses for pilotage and in dispatch services from the expense base. There were no reimbursed expenses in the District One expense base.

In District Three, we adjusted 2002 operating expenses because the pilot Association was unable to collect pilotage fees from one ship in 2001. The Association included this $14,190 expense under the title ''provision for doubtful accounts'' in the Association's 2001 financial statements. These funds were later recovered in 2002 and included as a reduction in operating expenses on the Association's financial statements. In the independent accountant's 2001 report on the Association, this expense was excluded from the ratemaking expense base. This 2002 recovery has been similarly excluded as an adjustment to the expense base. Generally accepted accounting principles would classify this recovery as ''other income'' not as a reduction of expenses.

Not Recognized Expenses

Lobbying expenses and certain miscellaneous expenses such as advertising, business promotion, and donations were identified as unnecessary for the provision of pilotage services.

The Coast Guard adopted the independent accountant's recommendation to deduct $21,000 in lobbying fees from District One's expense base and $9,000 from District Three's expense base. District Two reported no lobbying expenses in 2002. Lobbying expenses are specifically excluded by regulation—46 CFR 404.5(a)(8)(ii). An expense item for business promotion in District Two of $882 was also deducted. Lastly, we deducted $471 for charitable donations from District Three's expense base. The Coast Guard adopted the independent accountant's recommendation to deduct these expenses because none were necessary for the provision of pilotage services.

Reclassified Expenses

The independent accountant recommended deductions of $13,970 (dues payments), $2,500 (training expenses) and $118,919 (contract pilotage service) from District One; $9,300 (meeting expense) and $15,840 (association dues) from District Two; and $26,210 (dues and subscriptions) and $6,600 (union dues) from District Three because these payments were erroneously classified as expenses. These expenses were reclassified as pilot compensation for ratemaking purposes.

The $9,300 paid to pilots in District Two for attending yearly meetings was in addition to those payments pilots received for travel and per diem. Section 404.5 states that in determining reasonableness, such an expense item is measured against one of three criteria: (1) Comparable or similar expenses paid by others in the maritime industry, (2) comparable or similar expenses paid by other industries, and (3) U.S. Internal Revenue Service Guidelines. 46 CFR 404.5(a)(2). In this case, the appropriate criteria are provided by U.S. Internal Revenue Service guidelines. As set out in IRS Regulation 1.62–2(c)(5), travel costs that are not made under an ''accountable plan,'' one in which regular reporting of expenses by employees is required, are fully taxable to the employee and subject to Social Security and income tax withholding. Therefore, the Coast Guard reclassified these payments as pilot compensation, not expense reimbursements.

The remaining expenses, which are detailed below, are subject to 46 CFR 404.5(a)(6) which states that medical, pension, and other benefits paid to pilots, or for the benefit of pilots by the Association, are treated as pilot compensation.

District One paid $2,500 to registered pilots to train temporarily registered pilots on Lake Ontario and $118,919 to an independent registered pilot for the provision of pilotage services.

Deductions were also made for union dues in District One of $13,970, Association dues of $15,840 in District Two, and subscriptions and union dues of $6,600 and $26,210 in District Three. No provision for the payment of union dues, by employers, is provided for in the 2003 AMO union contract.

The independent accountant made several recommendations to reclassify certain sums of money as expenses for inclusion in the expense bases of the Associations in Districts One and Three. In District One, the independent accountant recommended that $23,578 paid by the Association for insurance to cover pilotage operations be reclassified as an expense rather than a member's distribution, as was done by the Association, because the expense is necessary and reasonable for the provision of pilotage services and AMO members would not be required to pay this expense.

In addition, District One reported pilot travel expenses in the amount of $10,500 under pilots' compensation rather than as an operating expense.

Additional travel costs of $12,076 incurred by river pilots, but not reimbursed by the St. Lawrence Seaway Pilots Association, were examined by the independent accountant. These unreimbursed expenses were supported by an adequate contemporaneous log and reported on a per trip basis. Any amount over $75 was documented according to existing Internal Revenue Code regulations for the substantiation of travel expenses. The Coast Guard adopted the independent accountant's recommendation that those amounts be reclassified as expenses.

In District Three, the Association reported $146,907 in pilot travel expenses under pilot compensation rather than as an operating expense. This amount has been reclassified as an operating expense. The pilots report their per diem expenses to the Association but do not get reimbursed for them as reported. Instead, the Association uses a schedule based on 200 travel days per pilot (per 187 days worked) and provides reimbursement in accordance with this schedule. Temporarily registered pilots are paid a per diem allowance and all pilots are reimbursed for actual hotel and temporary lodging expenses. No unallowable administrative travel costs were identified during the review.

Undocumented Expenses

The independent accountant's examination of District Two's financial statements noted payments of a $38 daily meals and incidental expense per diem based on days available, generally about 265 days per pilot. These per diem payments totaled $115,160. The Federal Travel Regulations (41 CFR part 301–11) do not contemplate a payment based on days available for travel. The IRS procedure in Rev. Proc. 2001.47 (2001) requires substantiation as to time, place, and purpose for expenses paid.

Internal Revenue Service regulations currently allow for ''reasonable business practice'' in reimbursement of per diem costs. Given that pilots are often at remote sites waiting for ships, allowable per diem expenses are based on approximately two days per diem for each passage or 200 days travel per pilot per 100 days worked. Recalculating the per diem expense shows that the allowable amount to be expensed is $97,980. The Coast Guard adopted the independent accountant's recommendation and the balance of $17,180 was reclassified as pilot compensation.

Foreseeable Circumstances

Finally, an additional expense projection of $8,086 was made for pilot travel and Social Security expenses and benefits associated with the addition of 766 additional bridge hours for pilots to cover the 50 percent of vessel traffic in Area 2 required under the Memorandum of Arrangements with Canada.

Adjustment for Inflation

In making projections of future expenses, expenses that are subject to inflationary or deflationary pressures are adjusted. Annual cost inflation or deflation will be projected to the succeeding navigation season, reflecting the increase or decrease in costs throughout the year. Upon the recommendation of the independent accountant, the Coast Guard adopted the adjustments for inflation for the years 2003 and 2004 based on the U.S. Department of Labor, Bureau of Labor Statistics, ''Midwest Economy—Consumer Price'' using the years 2002 to 2003 annual average in the amount of 1.9 percent per year.

Projection of Operating Expenses

Once all adjustments are made to the recognized operating expenses, the Coast Guard projects those expenses for each pilotage area. For the remainder of the 2004 and for the 2005 navigation seasons, the Coast Guard projects that operating expenses will remain the same as the 2002 navigation season. Operating expenses over the last several years have remained steady across all three Districts. The Coast Guard believes that there are no foreseeable circumstances that will cause the projection for the remainder of the 2004 and for the 2005 seasons to be so different from the 2002 navigation season to require an adjustment. General and administrative expenses are apportioned to each Area according to the number of pilots needed in that Area. For the remainder of the 2004 and for the 2005 navigation seasons, the projection of operating expenses are:

District one	Area 1 St. Lawrence River	Area 2 Lake Ontario	Total district one
Projection of operating expenses	$300,682	$348,803	$649,485

District two	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total district two
Projection of operating expenses	$419,205	$499,967	$919,172

District three	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Projection of operating expenses	$693,924	$269,645	$424,070	$1,387,639

Step 2: Projection of Target Pilot Compensation

(1) The second step in the ratemaking analyses and methodology is to project the amount of target pilot compensation that pilotage rates should provide in each Area. This step consists of the following:

a. Determination of the target rate of compensation;

b. Determination of the number of pilots needed in each pilotage area; and

c. Multiplication of target compensation by the number of pilots needed to project target pilot compensation needed in each Area. Each of these is detailed below.

Determination of Target Pilot Compensation

(1) Target pilot compensation for pilots providing services in undesignated waters approximates the average annual compensation for first mates on U.S. Great Lakes vessels. The average annual compensation for first mates is determined based on the most current AMO union contracts, and includes wages and benefits received by first mates.

(2) Target pilot compensation for pilots providing services in designated waters approximates the average annual compensation for masters on U.S. Great Lakes vessels. The Coast Guard has consistently calculated compensation for pilots on designated waters by multiplying first mates' salary portion of their compensation by 150 percent and adding benefits as required by 46 CFR part 404, Appendix A, Step 2.A(2).

(3) First mates' pay is calculated under the AMO union contracts on a daily wage rate basis and is then multiplied by the average days per

month, plus certain additional entitlements, yielding a monthly multiplier, as follows:

a. Average Working Days per Month	30.5
b. Vacation Days per month	15.0
c. Weekend Days per month	4.0
d. Holidays per month	1.5
e. Bonus per month	3.0
Monthly Multiplier	54.0

The monthly multiplier (54 days) is then multiplied by the daily rate for first mates ($220.35) under the 2003 AMO union contract, yielding the total monthly pay rate of $11,898.90, and a total annual pay rate, without benefits, of $107,090.10.

The Coast Guard has then consistently multiplied the monthly pay rate by nine months, the approximate length of the Great Lakes shipping season. For a first mate, this would be equivalent to working every day of those nine months. Several comments on this rulemaking stated that this is inappropriate because pilots do not work every day of the shipping season and this led to the suggestions to reduce the 54-day monthly multiplier.

After review of these comments, the Coast Guard decided to continue to use the 54-day monthly multiplier and the nine-month shipping season. The Coast Guard's goal in determining target pilot compensation is to approximate the compensation of first mates and masters on U.S. Great Lakes vessels. Over the course of the entire shipping season, however, pilots, first mates, and masters generally do not work the same number of days, making a comparison of actual or average days worked inappropriate since the goal is to achieve comparable annual compensation. Indeed, each first mate and master may work different numbers of days resulting in different overall actual compensation. Similarly, pilots working primarily in designated waters have to work fewer hours than pilots working primarily in undesignated waters for each to work a sufficient number of bridge hours to achieve their target compensation. Consequently, comparing days worked is not a useful measure to ensure that pilots receive annual compensation (wages) comparable to the annual compensation (wages) of a first mate or master working on U.S. Great Lakes vessels.

First mates and masters do not generally work every day of the shipping season. As a result, calculating target compensation by multiplying both the monthly wages and the monthly benefits by nine months—the equivalent compensation of a first mate or master working every day of the shipping season—would result in a target pilot compensation exceeding the annual compensation of first mates and masters on U.S. Great Lakes vessels. This would also be inappropriate.

In each of its prior ratemakings the Coast Guard has calculated benefits based on 180 days/6 months worked per navigation season and has calculated wages based on nine months worked per navigation season. This results in a blended total compensation figure between target compensation that would be too high (assuming pilots worked every day of the navigation season) and target compensation that would be too low (assuming pilots only worked 180 days in a navigation season). While comments suggested alternative methods of calculating pilot compensation, none of the comments provided sufficient supporting data to demonstrate that those alternatives better approximated the annual compensation of first mates and masters serving on U.S. Great Lakes vessels. The Coast Guard will therefore maintain its current method of calculating target compensation.

(4) The tables below summarize how total target pilot compensation is determined for undesignated and designated waters:

TABLE 1.—WAGES

Monthly component	(First mate) Pilots on undesignated waters	(Master) Pilots on designated waters
$220.35 (Daily Rate) × 54 (Days)	$11,899	N/A
Monthly Total × 9 Months = Total Wages	107,090	N/A
Wages: $220.35 (Daily Rate) × 54 × 1.5	N/A	$17,848
Monthly Total × 9 Months = Total Wages	N/A	160,635

TABLE 2.—BENEFITS

Monthly component	(First mate) Pilots on undesignated waters	(Master) Pilots on designated waters
Employer Contribution—401(k) Plan	$552.64	$828.96
Clerical	330.53	330.53
Health	2,064.79	2,064.79
Pension	1,283.10	1,283.10
Monthly Total Benefits	4,231.05	4,507.37
Monthly Total Benefits × 6	25,386	27,044
Total Wages Plus Benefits	132,476	187,679

Effective August 1, 2001, AMO union contracts provided ''that employers will make matching contributions for each participating 401(k) plan employee in an amount equal to 42 percent of the employee's contribution, to a maximum to 4.2 percent of a participating employee's compensation.'' Effective August 1, 2002, the matching benefit increased to 50 percent for each participating 401(k) employee up to a maximum of 5 percent of a participating employee's compensation. For purposes of this benefit, the AMO union contracts interpret ''employee compensation'' to mean base wages. District Two has a pension plan, while District Three has a 401(k) plan. District One does not provide either a 401(k) or pension plan for its members. Therefore, to conform to the AMO union contracts in accounting for employer contributions of 42 percent during the first four months of the season and 50 percent for the last five months of the navigation season, pilot compensation for Districts Two and Three are increased. The increase in undesignated waters is $3,315.84 and for designated waters is $4,973.64 per pilot. These increases are 4.2 percent and 5 percent of compensation, respectively.

District One does not administer any form of 401(k) or retirement plan. As a consequence, in the NPRM, a decision was made not to permit the District One Association to benefit by obtaining the matching expense. At the recommendation of the independent accountant, the Coast Guard has determined that the District One Association pilots should receive the same employer matching benefits as Districts Two and Three.

This decision is analogous to the Social Security and Medicare equalization performed earlier to equalize benefits between District Two and Districts One and Three respecting corporate payment of Social Security and Medicare benefits that are not paid by Districts One and Three. Accordingly, the compensation base of District One is adjusted to include an amount equivalent to an employer's contribution under the AMO 401(k) matching plan, which increases pilot compensation in undesignated waters by $3,315.84 and for designated waters by $4,973.64, per pilot.

The calculation of 401(k) matching benefits for undesignated and designated waters appear in the tables below:

Employer contributions	
UNDESIGNATED WATERS	
42%	$11,898.90 × .042 × 4 ÷ 9 = $222.11
50%	$11,898.90 × .050 × 5 ÷ 9 = $330.53
	$222.11 + 330.53 = $552.64
Pilot Compensation for 401(k)plan	$552.64 × 6 = $3,315.84
DESIGNATED WATERS	
42%	$17,848 × .042 × 4 ÷ 9 = $333.16
50%	$17,848 × .050 × 5 ÷ 9 = $495.78
	$333.16 + 495.78 = $828.94
Pilot Compensation for 401(k) plan	$828.94 × 6 = $4,973.64

Determination of Number of Pilots Needed

(1) The number of pilots needed in each Area of designated waters is established by dividing the projected bridge hours for that Area by 1,000. Bridge hours are the number of hours a pilot is aboard a vessel providing pilotage service.

(2) The number of pilots needed in each Area of undesignated waters is established by dividing the projected bridge hours for that Area by 1,800.

(3) The 1,000 hours in paragraph (1) and 1,800 hours in paragraph (2) are the target number of bridge hours a pilot needs to earn target pilot compensation.

(4) The Coast Guard used the results in calculating target pilot compensation and paragraphs (1) through (3) in ''Determination of Number of Pilots Needed'' to calculate the proper number of pilots needed for each pilotage Area. Although we had originally included a projection for the fast-ferry between Rochester, NY, and Toronto, Canada, on Lake Ontario, the ferry is not operating. Therefore, this rule does not contain any adjustments for fast-ferry pilotage needs in Area 2. However, the Coast Guard made adjustments to the number of pilots needed for Area 2 to ensure sufficient pilots to provide 50 percent of the pilotage service projected in that Area. The Memorandum of Arrangements Great Lakes Pilotage Between the Secretary of Transportation of the United States of America and the Minister of Transport of Canada (Dated January 18, 1977, Washington, DC, and January 18, 1977, Ottawa, Canada,) hereafter Memorandum of Arrangements, requires that we share traffic equally in Area 2 with the Canadian pilots requiring 766 additional bridge hours. In 2002, Area 2 reported bridge hours totaling 5,951 or 44.3 percent of pilotage service provided by U.S. pilots. Because, the MOA with Canada requires that pilotage service for Area 2 be equally divided between the United States and Canada, we increased the percentage of pilotage service in our projection from 44.3 percent to 50 percent. By increasing pilot service hours from 44.3 percent to 50 percent, we increased the bridge hour levels from 5,951 to the projected 6,717. This change results in an increase of 766 hours.

(5) Projected bridge hours are based on the vessel traffic that pilots are expected to serve. The Coast Guard projects, with the exception of Area 2 as discussed above, that bridge hours for the remainder of the 2004 and for the 2005 navigation season will be comparable to that of 2002. Dividing the projected annual number of bridge hours per area by the target number of bridge hours per pilot results in the number of pilots that will be needed in each Area to service vessel traffic.

(6) The following table shows the calculation of the number of pilots needed in each Area for the remainder of the 2004 and for the 2005 navigation season:

Pilotage area	Projected 2003 bridge hours	Divided by bridge-hour target	Pilots needed [1]
Area 1	5,010	1,000	5.0
Area 2	6,717	1,800	3.7
Area 4	8,139	1,800	4.5
Area 5	6,395	1,000	6.4
Area 6	18,000	1,800	10.0
Area 7	3,863	1,000	3.9

Pilotage area	Projected 2003 bridge hours	Divided by bridge-hour target	Pilots needed [1]
Area 8	11,390	1,800	6.3

[1] The results of calculation of pilots needed has been rounded to one place to the right of the decimal. For example, in Area 1, 5,010 projected hours divided by 1,000 target hours is actually 5.01 pilots needed.

Projection of Target Pilot Compensation

(1) The projection of target pilot compensation is determined separately for each pilotage Area by multiplying the number of pilots needed in each Area by the target pilot compensation for pilots working in that Area.

(2) The results for each pilotage Area are set out below:

District one	Area 1 St. Lawrence River	Area 2 Lake Ontario	Total district one
Projection of target pilot compensation	$940,274	$494,358	$1,434,632

District two	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total district two
Projection of target pilot compensation	$599,014	$1,200,210	$1,799,224

District three	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Projection of target pilot compensation	$1,324,764	$725,005	$838,281	$2,888,051

Step 3: Projection of Revenue

(1) The third step in the ratemaking analyses and methodology is to project the revenue that would be received in each pilotage Area if existing rates were left unchanged. This calculation uses both the projection of vessel traffic for 2004 and for 2005 and current pilotage rates.

Projection of Revenue

(1) The Coast Guard projects the pilotage service that will be required by vessel traffic in each pilotage area. These projections are based on a review of 2001 and 2002 data. In this case, the Coast Guard projected that vessel traffic for the remainder of the 2004 and for the 2005 navigation seasons would remain the same as traffic during 2002. Traffic will remain the same, but the percentage of traffic serviced by Area 2 will increase as previously discussed. This projected demand was multiplied by the rates contained in the 2004 partial-rate adjustment to arrive at projected revenue.

(2) The results of the projection of revenue for each District are summarized below:

District one	Area 1 St. Lawrence River	Area 2 [1] Lake Ontario	Total district one
Projection of revenue	$1,041,032	$735,224	$1,776,256

District two	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total district two
Projection of revenue	$824,888	$1,337,241	$2,162,129

District three	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Projection of Revenue	$1,760,947	$864,911	$1,131,740	$3,757,599

[1] This figure includes an adjustment for increased traffic due to servicing a larger percentage of ships to satisfy our obligations under the MOA with Canada.

Step 4: Calculation of Investment Base

(1) The fourth step in the ratemaking analyses and methodology is the calculation of the investment base of each Association. The investment base is the recognized capital investment in the assets employed by each Association required to support pilotage operations. In general, it is the sum of available cash and the net value of real assets, less the value of land. The investment base has been established through the use of the balance sheet accounts, as amended by material supplied in the notes to the independent accountant's financial statements, which are in the public docket.

(2) The formula for determining the investment base appears at Appendix B to part 404. The calculation appears in the independent accountant's reports for each district. The investment base is equal to the recognized assets multiplied by the ratio of recognized sources of funds to total sources of funds. The investment base as calculated for each District is displayed below:

District one		Area 1 St. Lawrence River	Area 2 Lake Ontario	Total district one
Calculation of investment base		$142,622	$179,637	$322,259
District two		Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total district two
Calculation of investment base		$358,974	$428,132	$787,106
District three	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Calculation of investment base	$445,915	$172,274	$272,507	$890,696

Step 5: Determination of Target Rate of Return on Investment

(1) The fifth step in the ratemaking analyses and methodology is to determine the target rate of return on investment. For each Association, a market-equivalent return on investment is allowed for the recognized net capital invested in the Association by its members.

(2) The allowed return on investment is equal to the preceding year's average annual rate of return for new issues of high-grade corporate securities.

(3) Assets subject to return on investment provisions must be reasonable in both purpose and amount. If an asset or other investment is not necessary for the provision of pilotage services, that portion of the return element is not allowed for ratemaking purposes.

(4) The target rate of return on investment for 2002 was 5.67 percent. This figure is the preceding year's (2001's) average annual rate of return on new issues of high-grade corporate securities in Moody's AAA rating, average return.

Step 6: Adjustment Determination

Projected Rate of Return on Investment

(1) The next step in the ratemaking analyses and methodology is to insert the results from steps 1, 2, 3, and 4 into a formula and to compare the results to step 5. This step considers revenues, expenses, and rates of return on investment, as set out below:

ADJUSTMENT DETERMINATION

[Projected rate of return on investment]

Line	Ratemaking projections for basic pilotage
1	+ Revenue (from Step 3).
2	− Operating Expenses (from Step 1).
3	− Pilot Compensation (from Step 2).
4	= Operating Profit/(Loss).
5	− Interest Expense (from financial reports).
6	= Earnings Before Tax.
7	− Federal Tax Allowance.
8	= Net Income.
9	Return Element (Net Income + Interest).
10	÷ Investment Base (from Step 4).
11	= Projected Rate of Return on Investment.

DISTRICT ONE—PROJECTED RATE OF RETURN ON INVESTMENT

Line	Area 1	Area 2	Total district one
1	$1,041,032	$735,224	$1,776,256
2	300,682	348,803	649,485
3	940,274	494,358	1,434,632
4	(199,924)	(107,937)	(307,861)
5	0	0	0
6	(199,924)	(107,937)	(307,861)
7	0	0	0
8	(199,924)	(107,937)	(307,861)
9	(199,924)	(107,937)	(307,861)
10	142,622	179,637	322,259
11	(1.402)	(0.601)	(1.001)

DISTRICT TWO—PROJECTED RATE OF RETURN ON INVESTMENT

Line	Area 4	Area 5	Total district 2
1	$824,888	$1,337,241	$2,162,129
2	419,205	499,967	919,172
3	599,014	1,200,210	1,797,224
4	(193,331)	(362,936)	(554,267)
5	9,028	9,028	18,056
6	(202,359)	(371,964)	(572,323)
7	4,282	4,282	8,564
8	(206,641)	(376,246)	(580,887)
9	(197,613)	(367,218)	(562,831)
10	358,974	428,132	787,106

DISTRICT TWO—PROJECTED RATE OF RETURN ON INVESTMENT—Continued

Line	Area 4	Area 5	Total district 2
11	(0.550)	(0.858)	(0.704)

DISTRICT THREE—PROJECTED RATE OF RETURN ON INVESTMENT

Line	Area 6	Area 7	Area 8	Total district
1	$1,760,947	$864,911	$1,131,740	$3,757,598
2	693,924	269,645	424,070	1,387,639
3	1,324,764	725,005	838,281	2,888,050
4	(257,741)	(129,739)	(130,611)	(518,091)
5	1,235	1,235	1,235	3,705
6	(258,976)	(130,974)	(131,846)	(514,386)
7	0	0	0	0
8	(258,976)	(130,974)	(131,846)	(514,386)
9	(257,741)	(129,739)	(130,611)	(510,681)
10	445,915	172,274	272,507	891,696
11	(0.578)	(0.753)	(0.479)	(0.603)

(2) The Coast Guard compares projected rates of return on investment, from Step 6, to target rates of return on investment, from Step 5, to determine whether an adjustment to the pilotage rates is appropriate. If the projected rates of return on investment are different from the target rates of return on investment, the revenues that would be generated by the current pilotage rates will not equal the revenues needed to reach target pilot compensation.

(3) The differences between the projected rates of return on investment and the target rates of return on investment in the table below demonstrate that a rate adjustment is appropriate.

TABLE D.—COMPARISON OF PROJECTED RATE OF RETURNS ON INVESTMENT AND TARGET RATE OF RETURN ON INVESTMENT

	Projected return on investment	Target return on investment	Difference in return on investment
District One	(1.001)	.0567	(0.945)
District Two	(0.704)	.0567	(0.647)
District Three	(0.603)	.0567	(0.547)

(4) The Coast Guard projects the revenues needed to make the projected rates of return on investment equal to the target rates of return on investment.

Revenue Needed Adjustment Determination

The formula used to calculate the revenue needed adjustment determination is similar to the formula used in determining the projected rates of return on investment.

REVENUE NEEDED ADJUSTMENT DETERMINATION

Line	Ratemaking projections for basic pilotage
1	+ Revenue (Revenue Needed).
2	− Operating Expenses (from Step 1).
3	− Pilot Compensation (from Step 2).
4	= Operating Profit/(Loss).
5	− Interest Expense (from financial reports).
6	= Earnings Before Tax.
7	− Federal Tax Allowance.
8	= Net Income.
9	= Return Element (Net Income + Interest).
10	÷ Investment Base (from Step 4).
11	= Revenue Needed Adjustment Rate.

To find the proper adjustment determination, projected revenue, as determined in Step 3, is adjusted in each Area until the formula used in determining the projected rates of return on investment yields projected rates of return on investment equal to the target rates of return on investment from Step 5. The following tables show the results of these calculations:

DISTRICT ONE—ADJUSTMENT DETERMINATION

Line	Area 1	Area 2	Total district one
1	$1,249,042	$853,346	$2,102,389
2	300,682	348,803	649,485
3	940,274	494,358	1,452,903
4	8,087	10,185	18,272
5	0	0	0

DISTRICT ONE—ADJUSTMENT DETERMINATION—Continued

Line	Area 1	Area 2	Total district one
6	8,087	10,185	18,272
7	0	0	0
8	8,087	10,185	18,272
9	8,087	10,185	18,272
10	142,622	179,637	322,259
11	.0567	.0567	.0567

DISTRICT TWO—ADJUSTMENT DETERMINATION

Line	Area 4	Area 5	Total district 2
1	$1,042,855	$1,728,734	$2,771,589
2	419,205	499,967	919,172
3	599,014	1,200,210	1,799,224
4	24,636	28,557	53,193
5	9,028	9,028	18,056
6	15,608	19,529	35,137
7	4,282	4,282	8,564
8	11,326	15,247	26,573
9	20,354	24,275	44,629
10	358,974	428,132	787,106
11	.0567	.0567	.0567

DISTRICT THREE—ADJUSTMENT DETERMINATION

Line	Area 6	Area 7	Area 8	Total district
	$2,043,972	$1,004,418	$1,277,802	$4,326,192
2	693,924	269,645	424,070	1,387,639
3	1,324,764	725,005	838,281	2,888,050
4	25,283	9,768	15,451	50,503
5	1,235	1,235	1,235	3,705
6	24,048	8,533	14,216	46,798
7	0	0	0	0
8	24,048	8,533	14,216	46,798
9	25,283	9,768	15,451	50,503
10	445,915	172,274	272,507	890,696
11	.0567	.0567	.0567	.0567

Step 7: Adjustment of Pilotage Rates

(1) The final step in the ratemaking analyses and methodology is to adjust pilotage rates if the calculations from Step 6 indicate that pilotage rates in a pilotage area should be adjusted, and if the Coast Guard determines that a rate adjustment is appropriate.

(2) Pilotage rate adjustments are calculated for each area by multiplying the existing pilotage rates in each area by the rate multiplier. The rate multiplier is calculated by inserting the result from the steps detailed above into the following formula:

Line	Rate multiplier
1	Revenue Needed (from Step 6(C))
2	÷ Projected Revenue (from Step 3)
3	= Rate multiplier

(3) The following are the calculations for the rate multiplier by District and Area:

TABLE A DISTRICT 1—RATE MULTIPLIER

[Revenue Needed ÷ Projected Revenue = Rate Multiplier]

Area 1	$1,249,042	÷$1,041,032	1.20
Area 2	853,346	÷735,224	1.16
District Total	2,102,389	÷1,776,256	1.18

TABLE B DISTRICT 2—RATE MULTIPLIER

[Revenue Needed ÷ Projected Revenue = Rate Multiplier]

Area 4	$1,042,855	÷$824,888	1.26
Area 5	1,728,734	÷1,337,241	1.29

TABLE B DISTRICT 2—RATE MULTIPLIER—Continued

[Revenue Needed ÷ Projected Revenue = Rate Multiplier]

District Total	2,771,589	÷2,162,129	1.28

TABLE C DISTRICT 3—RATE MULTIPLIER

[Revenue Needed ÷ Projected Revenue = Rate Multiplier]

Area 6	$2,043,972	÷$1,760,947	1.16
Area 7	1,004,418	÷864,911	1.16
Area 8	1,277,802	÷1,131,740	1.13
District Total	4,326,192	÷3,757,599	1.15

TOTAL ACROSS ALL DISTRICTS—RATE MULTIPLIER

[Revenue Needed ÷ Projected Revenue = Rate Multiplier]

District One Total	$2,102,389	÷$1,776,256	1.18
District Two Total	2,771,589	÷2,162,129	1.28
District Three Total	4,326,192	÷3,757,599	1.15
All Districts	9,200,170	÷7,695,983	1.20

The seven-step calculation of the methodology is summarized in the tables below for each District.

DISTRICT ONE

	Area 1 St. Lawrence River	Area 2 Lake Ontario	Total district one
Step 1, Projection of operating expenses	$300,682	$348,803	$649,485
Step 2, Projection of target pilot compensation	940,274	494,358	1,434,632
Step 3, Projection of revenue	1,041,032	735,224	1,776,256
Step 4, Calculation of investment base	142,622	179,637	322,259
Step 5, Determination of target return on investment	5.67%	5.67%	5.67%
	8,087	10,185	18,272
Step 6, Adjustment determination	1,249,042	853,346	2,102,389
Step 7, Adjustment of pilotage rates	1.20	1.16	1.18

DISTRICT TWO

	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron, MI	Total district two
Step 1, Projection of operating expenses	$419,205	$499,967	$919,172
Step 2, Projection of target pilot compensation	599,014	1,200,210	1,799,224
Step 3, Projection of revenue	824,888	1,337,241	2,162,129
Step 4, Calculation of investment base	358,974	428,132	787,106
Step 5, Determination of target return on investment	5.67%	5.67%	5.67%
	20,354	24,275	44,629
Step 6, Adjustment determination	1,042,855	1,728,734	2,771,589
Step 7, Adjustment of pilotage rates	1.26	1.29	1.28

DISTRICT THREE

	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Step 1, Projection of operating expenses	$693,924	$269,645	$424,070	$1,387,639
Step 2, Projection of target pilot compensation	1,324,764	725,005	838,281	2,888,051
Step 3, Projection of revenue	1,760,947	864,911	1,131,740	3,757,598
Step 4, Calculation of investment base	445,915	172,274	272,507	890,696
Step 5, Determination of target return on investment	5.67%	5.67%	5.67%	5.67%
	25,283	9,768	15,451	50,502

DISTRICT THREE—Continued

	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total district three
Step 6, Adjustment determination	2,043,972	1,004,418	1,277,802	4,326,192
Step 7, Adjustment of pilotage rate	1.16	1.16	1.13	1.15

(4) Based on the above calculations and all the documents and records used in this full-rate adjustment, the Coast Guard has determined it is appropriate to adjust the rates in accordance with the above table.

(5) The Coast Guard amends the pilotage rates for the waters treated in 46 CFR 401.405 through 46 CFR 401.410 by multiplying the current pilotage rates by the rate multiplier for each pilotage Area. The following table shows the percentage changes in rates by Area.

2004 AREA RATE CHANGES

If pilotage service is required in:	Then the rate represents a change over the current rate of: (percent)
Area 1 (Designated waters)	20
Area 2 (Undesignated waters)	16
Area 4 (Undesignated waters)	26
Area 5 (Designated waters)	29
Area 6 (Undesignated waters)	16
Area 7 (Designated waters)	16
Area 8 (Undesignated waters)	13

Regulatory Evaluation

Executive Order 12866, ''Regulatory Planning and Review'', 58 FR 51735, October 4, 1993, requires a determination whether a regulatory action is ''significant'' and therefore subject to review by the Office of Management and Budget (OMB) and subject to the requirements of the Executive Order. This rule has been identified as significant under Executive Order 12866 and has been reviewed by OMB and DHS.

This rulemaking provides a 20 percent overall average increase in pilotage rates for the Great Lakes system, effective March 1, 2005. This increase will be a full-rate adjustment in addition to the five percent average partial-rate adjustment provided by the interim rule, 68 FR 69564, December 12, 2003.

These adjustments to Great Lakes pilotage rates meet the requirements set forth in 46 CFR part 404 for similar compensation levels between Great Lakes pilots and industry. They also include adjustments for inflation and changes in the prices for the Associations' expenses, such as insurance fees and pilot travel costs. The full-rate adjustment in this interim rule uses financial data from the 2002 base accounting year. The last full-rate adjustment occurred in 2001 and used financial data from the 1997 base accounting year.

The increase in pilotage rates will be an additional cost for shippers to transit the Great Lakes system. The shippers affected by this full-rate adjustment are those owners and operators of domestic vessels operating on register (employed in the foreign trade) and owners and operators of foreign vessels on a route within the Great Lakes system. These owners and operators must have pilots or pilotage service as required by 46 U.S.C. 9302. There is no minimum tonnage limit or exemption for these vessels. However, the Coast Guard issued a policy position several years ago stating that the statute applies only to commercial vessels and not to recreational vessels.

Owners and operators of other vessels that are not affected by this interim rule, such as recreational boats and vessels only operating within the Great Lakes system, may elect to purchase pilotage services. However, this election is voluntary and does not affect the Coast Guard's calculation of the rate increase and is not a part of our estimated national cost to shippers.

For instance, after a review of some pilot source forms, the forms used to record the actual pilotage transaction on the vessel, we discovered a case of a U.S. Great Lakes vessel, a small tanker without registry, that purchased pilotage services in District One to presumably leave the Great Lakes. This vessel, however, is recorded in the Coast Guard's data as a vessel operating only in the Great Lakes, which would make it exempt from the pilotage requirements. After consulting with the Coast Guard's Office of Great Lakes Pilotage, the determination was made that this vessel voluntarily chose to use pilots because of the type of cargo it was carrying, possibly hazardous, and the inexperience of the vessel's crew to navigate the locks and passages of District One.

We used recent arrival data from the Coast Guard's National Vessel Movement Center (NVMC) to estimate the annual number of vessels affected by the full-rate adjustment to be 217 vessels that, for some, make several journeys or trips into the Great Lakes system. These vessels entered the Great Lakes by transiting through or in part of at least one of the three pilotage Districts before leaving the Great Lakes system. These vessels often make several stops docking, offloading, and onloading at facilities in Great Lakes ports that may or may not involve a pilot. Of the total trips for the 217 vessels, there were a total of 1,095 distinct U.S. port arrivals before the vessels left the Great Lakes system.

We used district pilotage revenues from the independent accountant's reports of the Districts' financial statements to estimate the additional cost to shippers of the full-rate adjustment. These revenues represent the direct and indirect pilotage costs that shippers must pay for pilotage services in order to transit their vessels in the Great Lakes. Table 1 shows historical pilotage revenues by District.

TABLE 1.—DISTRICT REVENUES

($US)

Year	District 1	District 2	District 3	Total
1998	2,127,577	3,202,374	4,026,802	9,356,753
1999	2,009,180	2,727,688	3,599,993	8,336,861
2000	1,890,779	2,947,798	4,036,354	8,874,931
2001	1,676,578	2,375,779	3,657,756	7,710,113
2002	1,686,655	2,089,348	3,460,560	7,236,563

Source: Annual independent accountant's reports of the Districts to the Coast Guard's Office of Great Lake Pilotage.

While the revenues have decreased over time, the Coast Guard adjusts pilotage rates to achieve a target pilot compensation similar to masters and first mates working on U.S. vessels engaged in the Great Lakes trade.

We estimated the additional cost of the full-rate adjustment to be the difference between the full-rate adjustment revenue (revenue needed) and the projected 2005 revenue. Both of these revenue values are described and calculated in the *Ratemaking Process and Methodology* section of this interim rule. The projected revenue uses the 2002 revenues in Table 1 adjusted for the December 2003 interim rule, partial-rate adjustment, and the expected revenue due to changes in bridge hours. Table 2 compares base year, projected, and adjusted revenues (note: some values may not total due to rounding).

TABLE 2.—BASE YEAR, PROJECTED, AND ADJUSTED PILOTAGE REVENUES [1]

Year	District 1	District 2	District 3	Total
Base Revenue	1,686,655	2,089,348	3,460,560	7,236,563
Projected Revenue [2].				
('Base Revenue' + 'Partial-Rate Adjustment Revenue' + 'Bridge Hour Revenue Changes')	1,776,256	2,162,129	3,757,598	7,695,983
Full-Rate Adjustment Revenue [2]				
('Projected Revenue' × 'Full − Rate Adjustment Factor')	2,102,389	2,771,589	4,326,192	9,200,170
Additional Revenue or Cost				
('Full-Rate Adjustment Revenue' − 'Projected Revenue')	326,133	609,460	568,594	1,504,187

[1] Some values may not total due to rounding.

[2] For calculation of these figures, see the *Ratemaking Process and Methodology* section of this interim rule.

After applying the full-rate adjustment, the resulting difference between the full-rate adjustment revenue (revenue needed) and the projected revenue is the annual cost for the affected population of this interim rule, because this figure will be equivalent to the total additional payments that shippers will make for pilotage services.

The annual cost of the full-rate adjustment to shippers is approximately $1.5 million (non-discounted). To calculate an exact cost per vessel is difficult because of the variation in vessel types, routes, port arrivals, commodity carriage, time of season, conditions during navigation, and preferences for the extent of pilotage services on designated and undesignated portions of the Great Lakes system. Some owners and operators will pay more and some will pay less depending on the distance and port arrivals of their vessels' trips. However, the annual cost reported above does capture all of the additional cost the shippers will face as a result of this full-rate adjustment.

We estimated the total cost to shippers of the full-rate adjustment over a five-year period, because the Coast Guard is required to determine and, if necessary, adjust Great Lakes pilotage rates at a minimum of at least once every five years from the last full-rate adjustment. However, the Coast Guard does evaluate and analyze the Great Lakes pilotage rates every year, regardless of whether an adjustment is needed or not. The total cost estimate of this interim rule to shippers is discounted present value (PV) $6.6 million (2005–2009, seven percent discount rate).

The cost to shippers of this interim rule is minimal compared with the travel cost shippers save when they use the Great Lakes system. The alternative to Great Lakes waterborne transportation is to choose coastal delivery, such as East Coast and Gulf Coast ports which are more expensive, and extra-modal transportation overland, which is far less practical and has additional transportation costs for all commodity groups. See Coast Guard docket number USCG–2002–11288 for an assessment of alternatives to Great Lakes waterborne transportation and the associated costs entitled ''Analysis of Great Lakes Shipping and the Potential Impact of Pilotage Rate Increases'' (October 1, 2004). This assessment analyzes Great Lakes pilotage charges and their impact on ocean transportation costs as well as total through transportation costs.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601–612), we have considered whether this interim rule will have a significant economic impact on a substantial number of small entities in the United States. The term ''small entities'' comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000.

There are two U.S. entities, which are large shipping firms that operate foreign flagged vessels, engaged in foreign trade, in the Great Lakes system that will be affected by the full-rate increase and pay additional costs for pilotage services. The North American Industry Classification System (NAICS) code subsector for these shippers is 483-Water Transportation, and includes one or all of the following 6-digit NAICS codes for freight transportation: 483111-Deep Sea Freight Transportation, 483113-Coastal and Great Lakes Freight Transportation, and 483211-Inland Water Freight Transportation. According to the Small Business Administration's definition, a U.S. company with these NAICS codes and employing less than 500 employees is considered a small entity. These shippers do not qualify as small entities because their number of employees exceeds 500. We assume that new industry entrants will be comparable in size to these shippers with a large enough employee base and the financial resources to support long international trade routes and, thus, will not be small businesses.

There are three U.S. entities that are affected by the interim rule that will receive the additional revenues from the full-rate increase. These are the three pilot Associations that are the only entities providing pilotage services within the Great Lakes Districts. Two of the Associations operate as partnerships and one operates as a corporation. These Associations are classified with the same NAICS industry classification and small entity size standards as the U.S. shippers above, but they have far less than 500 employees: approximately 65 total employees combined. However, they are not adversely impacted with the additional costs of the full-rate increase, but instead receive the additional revenue benefits for operating expenses and pilot compensation.

Therefore, the Coast Guard certifies under 5 U.S.C. 605(b) that this interim rule will not have a significant economic impact on a substantial number of U.S. small entities. If you think that your business, organization, or governmental jurisdiction qualifies as a small entity and that this rule will have a significant economic impact on it, please submit a comment to the Docket Management Facility at the address under **ADDRESSES.** In your comment, explain why you think it qualifies and how and to what degree this rule would economically affect it.

Assistance for Small Entities

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this rule so that they can better evaluate its effects on them and participate in the rulemaking. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please call Paul Wasserman, Director, Office of Great Lakes Pilotage, (G–MWP–2), U.S. Coast Guard, telephone 202–267–2856 or send him e-mail at *pwasserman@comdt.uscg.mil.*

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247). The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

Collection of Information

This rule calls for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

Federalism

A rule has implications for federalism under Executive Order 13132, Federalism, if it has a substantial direct effect on State or local governments and would either preempt State law or impose a substantial direct cost of compliance on them. We have analyzed this rule under that Order and have determined that it does not have implications for federalism because there are no similar State regulations, and the States do not have the authority to regulate and adjust rates for pilotage services in the Great Lakes system.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of $100,000,000 or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

Taking of Private Property

This rule will not effect a taking of private property or otherwise have taking implications under Executive Order 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights.

Civil Justice Reform

This rule meets applicable standards in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Protection of Children

We have analyzed this rule under Executive Order 13045, Protection of Children from Environmental Health Risks and Safety Risks. This rule is not an economically significant rule and does not create an environmental risk to health or risk to safety that may disproportionately affect children.

Indian Tribal Governments

This rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

Energy Effects

We have analyzed this rule under Executive Order 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. We have determined that it is not a ''significant energy action'' under that order because even though it is a ''significant regulatory action'' under Executive Order 12866, it is not likely to have a significant adverse effect on the supply, distribution, or use of energy. The Administrator of the Office of Information and Regulatory Affairs has not designated it as a significant energy action. Therefore, it does not require a Statement of Energy Effects under Executive Order 13211.

Technical Standards

The National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through the Office of Management and Budget, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards are technical standards (*e.g.*, specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) that are developed or adopted by voluntary consensus standards bodies. This rule does not use technical standards. Therefore, we did not consider the use of voluntary consensus standards.

Environment

We have analyzed this rule under Commandant Instruction M16475.lD, which guides the Coast Guard in complying with the National Environmental Policy Act of 1969 (NEPA)(42 U.S.C. 4321–4370f), and have concluded that there are no factors in this case that would limit the use of a categorical exclusion under section 2.B.2 of the Instruction. Therefore, this rule is categorically excluded, under figure 2–1, paragraph (34)(a), of the Instruction, from further environmental documentation. An ''Environmental Analysis Check List'' and a ''Categorical Exclusion Determination'' are available in the docket where indicated under the section of this preamble on ''Public Participation and Request for Comments.'' We will consider comments on this section before we make the final decision on whether this rule should be categorically excluded from further environmental review.

List of Subjects in 46 CFR Part 401

Administrative practice and procedures, Great Lakes, Navigation (water), Penalties, Reporting and recordkeeping requirements, Seamen.

PART 401—GREAT LAKES PILOTAGE REGULATIONS

■ 1. The authority citation for part 401 continues to read as follows:

Authority: 46 U.S.C. 2104(a), 6101, 7701, 8105, 9303, 9304; Department of Homeland Security Delegation No. 0170.1; 46 CFR 401.105 also issued under the authority of 44 U.S.C. 3507.

■ 2. In § 401.405, revise paragraphs (a) and (b) to read as follows:

§ 401.405 Basic rates and charges on the St. Lawrence River and Lake Ontario.

* * * * *

(a) Area 1 (Designated Waters):

Service	St. Lawrence River
Basic Pilotage	[1] $10 per kilometer or $18 per mile.
Each Lock Transited	[1] $222.
Harbor Movage	[1] $728.

[1] The minimum basic rate for assignment of a pilot in the St. Lawrence River is $486 and the maximum basic rate for a through trip is $2,132.

(b) Area 2 (Undesignated Waters):

Service	Lake Ontario
Six-Hour Period	$379
Docking or Undocking	362

■ 3. In § 401.407, revise paragraphs (a) and (b) to read as follows:

§ 401.407 Basic rates and charges on Lake Erie and the navigable waters from Southeast Shoal to Port Huron, MI.

* * * * *

(a) Area 4 (Undesignated Waters):

Service	Lake Erie (east of Southeast Shoal)	Buffalo
Six-Hour Period	$510	$510
Docking or Undocking	393	393
Any Point on the Niagara River below the Black Rock Lock	N/A	1,003

(b) Area 5 (Designated Waters):

Any point on or in	Southeast Shoal	Toledo or any Port on Lake Erie west of Southeast Shoal	Detroit River	Detroit Pilot Boat	St. Clair River
Toledo or any port on Lake Erie west of Southeast Shoal	$1,211	$715	$1,571	$1,211	N/A
Port Huron Change Point	[1] 2,108	[1] 2,442	1,584	1,232	$876
St. Clair River	[1] 2,108	N/A	1,584	1,584	715
Detroit or Windsor or the Detroit River	1,211	1,571	715	N/A	1,584
Detroit Pilot Boat	876	1,211	N/A	N/A	1,584

[1] When pilots are not changed at the Detroit Pilot Boat.

■ 4. In § 401.410, revise paragraphs (a), (b), and (c) to read as follows:

§ 401.410 Basic rates and charges on Lakes Huron, Michigan, and Superior, and the St. Mary's River.

* * * * *

(a) Area 6 (Undesignated Waters):

Service	Lakes Huron and Michigan
Six-Hour Period	$390
Docking or Undocking	370

(b) Area 7 (Designated Waters):

Area	De tour	Gros cap	Any other harbor
Gros Cap	$1,383	N/A	N/A
Algoma Steel Corporation Wharf at Sault Ste. Marie, Ontario	1,383	$521	N/A
Any point in Sault Ste. Marie, Ontario, except the Algoma Steel Corporation Wharf	1,159	521	N/A
Sault Ste. Marie, Michigan	1,159	521	N/A

Area	De tour	Gros cap	Any other harbor
Harbor Movage	N/A	N/A	$521

(c) Area 8 (Undesignated Waters):

Service	Lake Superior
Six-Hour Period	$351
Docking or Undocking	334

§ 401.420 [Amended]

■ 5. In § 401.420—

■ a. In paragraph (a), remove the number ''$56'' and add, in its place, the number ''$67''; and remove the number ''$873'' and add, in its place, the number ''$1,048''.

■ b. In paragraph (b), remove the number ''$56'' and add, in its place, the number ''$67''; and remove the number ''$873'' and add, in its place, the number ''$1,048''.

■ c. In paragraph (c)(1), remove the number ''$330'' and add, in its place, the number ''$396''; in paragraph (c)(3), remove the number ''$56'' and add, in its place, the number ''$67''; and, also in paragraph (c)(3), remove the number ''$873'' and add, in its place, the number ''$1,048''.

§ 401.428 [Amended]

■ 6. In § 401.428, remove the number ''$337'' and add, in its place, the number ''$404''.

Dated: March 4, 2005.

Thomas H. Collins,

Admiral, U.S. Coast Guard, Commandant.

[FR Doc. 05–4586 Filed 3–4–05; 1:58 pm]

BILLING CODE 4910–15–P