

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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RAIL FUEL SURCHARGES (SAFE HARBOR)

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REPLY COMMENTS OF  
ARKANSAS ELECTRIC COOPERATIVE CORPORATION

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In its opening comments, Arkansas Electric Cooperative Corporation (AECC) offered several proposals for modifications of the Board's fuel surcharge rules. Those proposals sought to ensure conformity between railroad surcharge practices that rely on the "safe harbor" index and the standards established by the Board in Rail Fuel Surcharges, Docket No. 661, served Jan. 26, 2007 ("Fuel Surcharges"), as discussed further by the Board in Cargill, Inc. v. BNSF Railway Co., Docket No. NOR 42120, served Aug. 12, 2013 ("Cargill"), and in its decisions served May 29, 2014 and July 8, 2014 in this proceeding. The opening comments submitted by other parties in several instances confirm that adoption of AECC's proposals would significantly improve fuel surcharge practices.

DISCUSSION

A railroad's fuel cost for any given movement or group of movements, and even for its traffic base as a whole, is the product of the unit price of fuel and the amount of fuel required to effect the given movement(s). This is a mathematical identity that the Board recognized in Cargill, when it performed an explicit assessment of the fuel use parameters

associated with the application of the safe harbor index in that proceeding. 1/ Any assessment of the reasonableness of a given fuel price index on the basis of the correspondence or divergence between surcharge revenues and actual rail fuel cost changes must, one way or another, take into account both the fuel price and the quantity of fuel used. The reasonableness of fuel surcharge levels or practices cannot be established on the basis of a fuel price index irrespective of fuel use considerations. We address both components below.

1. Fuel Prices - A "True-Up" Procedure Will Ensure That Fuel Surcharges Are Based On Accurate Price Information.

Not surprisingly, the opening comments of railroad and shipper parties express widely divergent views about whether the railroads' current fuel surcharge mechanisms have reflected changes in fuel prices with reasonable accuracy. The railroads generally assert that their fuel surcharges track actual changes in fuel prices accurately. 2/ Shippers, on the other

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1/ Cargill at pages 14-16.

2/ BNSF claims that the disparity between actual and index fuel prices found in Cargill were an aberration, and since then "there has been virtually no divergence on an average annual basis between the HDF index and BNSF's internal fuel prices." BNSF Comments at 11. UP says that "[t]he HDF Index has a strong correlation with UP's fuel prices" which "demonstrates the continued reasonableness of maintaining the HDF Index safe harbor." UP Comments at 7. CN asserts that since 2008 "changes in the HDF Index and in CN's average fuel costs have generally tracked closely", and that that the difference between the HDF Index and CN's actual average fuel costs "has remained relatively stable over that time". CN Comments at 3. Of course, none of these claims have been substantiated in an adversarial proceeding.

hand, have presented evidence that railroad fuel surcharges have over-recovered the increases in fuel prices that the railroads actually have experienced. <sup>3/</sup>

Fortunately, information presented in the opening comments provides a basis for reconciling these divergent views. Specifically, the opening comments of The Dow Chemical Company (Dow) include an exhibit that presents time-series observations of the values of the safe harbor index and the actual fuel prices per gallon paid by 3 of the largest Class I railroads (UP, BNSF and CSX) during the same time periods. <sup>4/</sup> While Dow's analysis of these data demonstrated a degree of correlation between the safe harbor index and the average fuel

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<sup>3/</sup> The Allied Shippers describe a detailed analysis (see pp. 36-42 of their comments) and conclude that "all publicly available data shows that the growing spread issue the Board identified in Cargill is not an aberration and that, not surprisingly, the spread consistently favors the railroads." Allied Shippers Comments at 42. The National Industrial Transportation League (NITL) concludes from its analysis that the "data clearly suggests that the carriers' fuel surcharge programs are generally overrecovering fuel costs", but it notes that the overrecovery could be due, at least in part, to features of the fuel surcharge program other than the use of the HDF Index, such as "the strike price, the miles per gallon assumption and the incremental mileage charge, the mileage methodology, or other factors". NITL Comments at 8. Consumers United For Rail Equity (CURE) concluded that "railroads are over-recovering their fuel expenses through their surcharge programs." CURE Comments at 10.

In addition to shippers, the United States Department Of Agriculture (USDA) also concluded that the overrecovery found in Cargill was not an aberration. USDA Comments at (unnumbered pp) 2-3, and Highroad Consulting concluded that historical data and cost evidence reveals the Railroads continue to over-recover with their fuel Surcharge programs. Highroad Comments at 7-12.

<sup>4/</sup> Dow Comments, Exhibit 4.

prices actually paid, <sup>5/</sup> further clarity can be achieved by focusing on the differential between the index and the fuel price paid by each railroad in each time period, and the changes over time that have occurred in those differentials.

Because AECC's interests in this proceeding stem from its need to transport PRB coal, the following analysis and comments based on the Dow data focus primarily on the results for the railroads that serve the PRB, UP and BNSF. By inspection it appears that results for CSX would be essentially the same.

Figure 1 on the following page shows HDF Index and railroad-specific actual fuel cost per gallon values for the period from Q4 2007 through Q1 2014, as presented in Dow's opening comments. Figure 1 also presents the railroad-specific differentials between the HDF Index and actual fuel cost per gallon for the same time period, as computed by AECC from the Dow data. AECC's analysis of this information is as follows:

1. From Q4 2007 through Q1 2009, the differentials between the HDF Index and actual fuel cost per gallon were highly variable. For example, the differentials for UP and BNSF reached lows of \$0.22-0.24 per gallon in Q2 2008, then increased rapidly to \$1.31-1.55 per gallon in Q4 2008 before trending downward again. If this level of instability were to persist, it certainly would

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<sup>5/</sup> Dow explains (Comments at 10):

A simple regression analysis reveals that the major railroads' fuel surcharge programs have correlations of 0.79 to 0.90 compared to the HDF Index. See Exhibit 4. Yet, at the same time, some fuel surcharge programs are designed such that, as the price of fuel rises in the HDF Index, the corresponding fuel surcharge fee paid by shippers rises much more sharply.

# Figure 1

## Analysis of Dow Data



call into question the entire rationale for relying on HDF as a proxy for actual rail fuel cost per gallon.

2. Beginning in Q2 2009, the differentials exhibited improved stability. For example, for the entire period from Q2 2009 through Q1 2014, the differentials for UP and BNSF fell entirely within the range of \$0.40-0.99 per gallon. This still is a wide range for HDF to be viewed as a particularly good proxy, but it is not as unstable as during the earlier period.
3. Notwithstanding the improved stability observed during this time, the data from Q2 2009 through Q1 2014 exhibit an upward trend in differentials that substantiates the concerns of shippers (and the Board in Cargill) regarding fuel price overrecovery that can occur under the safe harbor. To the extent that the differentials are increasing over time, railroad use of the HDF Index in fuel surcharge calculations produces increasing levels of recovery relative to actual fuel cost per gallon. In fact, further analysis of the data in Figure 1 reveals that from Q2 2009 through Q1 2014 the differential experienced by UP did not vary around a steady value, but rather increased systematically by almost 50 percent. 6/ A similar analysis for BNSF shows its differential increased systematically by over 52 percent. 7/

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6/ Based on the change in value estimated by the regression analysis performed in the TREND function of Excel between Q2 2009 (\$0.570 per gallon) and Q1 2014 (\$0.847 per gallon).

7/ Based on the change in the TREND function estimates between Q2 2009 (\$0.530 per gallon) and Q1 2014 (\$0.808 per gallon).

The data show that fuel surcharges based on the HDF Index at one point produced results that deviated widely from actual rail fuel cost per gallon, and now are producing systematic and sustained increases in recovery relative to actual fuel cost per gallon.

A “true-up” procedure of the type AECC has proposed would address both of these circumstances. If periods of instability arise in the relationship between the index and actual fuel costs, or if that relationship trends in one direction or another, a true-up procedure would ensure – with a minimum of expense and acrimony - that railroad fuel surcharges recover only legitimate and actual changes in rail fuel costs. Even if, as the railroads claim, their fuel surcharges usually reflect fairly the changes in the fuel prices they pay, a true-up procedure would provide ongoing confirmation of such accuracy (if indeed the surcharges are as accurate as the railroads claim). Thus, a true-up procedure would allow an independent index, such as HDF, to be used as a safe harbor while fostering the advantages of transparency the Board has sought to promote.

2. Fuel Use – The Board Can and Should Require That Price Indices in Railroad Fuel Surcharges Be Applied to Reasonable Estimates of Actual Fuel Use.

AECC’s opening comments included four specific recommendations for ensuring the conceptual and computational validity of the fuel use estimates to which fuel price indices may be applied in a fuel surcharge mechanism:

1. Allow exclusion of the mileage associated with circuitry attributable to such factors as nonissue traffic and carrier market power;
2. Exclude categories of fuel costs not directly variable with issue traffic;
3. Ensure implicit fuel economy estimates are adjusted over time to reasonably reflect ongoing fuel use efficiency improvements; and,
4. Allow exceptions for demonstrated variations in fuel-use intensity.

Concerns and recommendations regarding the accuracy of fuel use estimates embedded in fuel surcharge programs appear in the opening comments of several other shipper parties. For example:

- NITL calls for periodic reviews of fuel use parameters to ensure their continued accuracy; 8/
- Colorado Springs Utilities (CSU), a PRB coal user, and the National Grain and Feed Association (NGFA) both point out the general need for accurate fuel use estimates, and specifically reference improvements in fuel use efficiency that the railroads have achieved; 9/
- Dow also discusses the need to account for efficiency improvements; 10/ and,
- Mercury Group references the importance of incorporating fuel efficiency improvements, and describes the vital importance of actual fuel use data to the efficiency of resource allocation in the economy. 11/

In stark contrast to the identification of fuel use issues and concerns by several shipper parties, the railroad comments are virtually silent on fuel use issues that may be relevant in computing fuel surcharges. UP goes so far, in its motion for extension of the procedural schedule, to accuse the shipper parties of filing “overly broad” comments, presumably because the shippers discuss full use issues. 12/ It is particularly inappropriate for UP to be making such a criticism: In another docket, UP recently described to the Board the

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8/ NITL Comments at 10.

9/ CSU Comments at 2-7; NGFA Comments at 3, 5.

10/ Dow Comments at 14-16.

11/ Mercury Group Comments at 2-3, 13-15.

12/ UP Motion for Extension of Procedural Schedule (August 7, 2014) at 2).

substantial and ongoing efforts it is making to improve fuel use efficiency. <sup>13/</sup> Those UP efforts substantiate the concerns expressed by shippers here that fuel use, like fuel price, is subject to change over time, and is no less important in ensuring the legitimacy of a fuel surcharge mechanism under the criteria the Board has articulated. If railroads improve fuel efficiency and use less fuel to effect a given movement, that will reduce the amount of fuel to which to apply a surcharge. Fuel use must be considered in evaluating a fuel surcharge, as the Board did in Cargill.

CSX Transportation, Inc. (CSX) makes the remarkable argument that the Board has no business considering whether a railroad's fuel surcharge accurately reflects changes in the railroad's fuel costs, so long as the railroad announces how it will calculate the surcharge, and then adheres to that description. CSX Comments at 3-4. If the Board were to accept this argument, it would basically remove any accountability on the part of rail management for the content of fuel surcharge programs.

One of the explicit goals of the rail transportation policy is "to encourage honest and efficient management of railroads". 49 U.S. Code §10101 (9). Based on that policy, the Board ruled in 2007 that

If the railroads wish to raise their rates they may do so, subject to the rate reasonableness requirement of the statute, but they may not impose those increases on their customers on the basis of a misrepresentation.

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<sup>13/</sup> Docket No. EP 722, Railroad Revenue Adequacy, "Opening Comments of Union Pacific Railroad Company" (September 5, 2014) at 18. This describes how UP is reducing fuel consumption rates by investing in new, fuel efficient locomotives and improving training and operating practices.

Rail Fuel Surcharges, Docket No. EP 661, served Jan. 26, 2007, at 7. If a railroad labels a charge as a “fuel surcharge”, the Board ruled that this constitutes a representation that the charge reflects the increase in the cost of fuel needed to provide transportation service to the customer – not necessarily exactly dollar for dollar, but with reasonable accuracy. As the Board explained in its 2007 Decision:

[T]he term “fuel surcharge” most naturally suggests a charge to recover increased fuel costs associated with the movement to which it is applied. If it is used instead as a broader revenue enhancement measure, it is mislabeled

Id. CSX’s argument ignores the Board’s 2007 Decision.

There are multiple sources of fuel use information that make it relatively easy for CSX and the other railroads to ensure the reasonable accuracy of fuel use parameters used in fuel surcharges, in conformity with the Board’s requirements. For example,

- Railroads read the fuel gauges and fill the locomotives with fuel, so they are fully aware of the total quantity of fuel consumed during the movement of trainload and unit train traffic;
- As part of prudent management, railroads do or should analyze the factors that contribute to fuel use, and the opportunities they have to reduce fuel use;
- The Class I’s are all members of the AAR, which historically has provided rail management with commercial-grade information related to fuel consumption, such as the “Train Energy Model”; 14/

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14/ See <http://trid.trb.org/view.aspx?id=293266> .

- As purchasers and lessees of locomotives, railroads have available detailed fuel use parameters, including fuel consumption by throttle position, for each locomotive in their fleets;
- As the parties that conduct maintenance of locomotive fleets, the railroads are intimately familiar with any fuel-efficiency retrofits that have been applied; and,
- As supervisors of operations, the railroads know the training and monitoring practices related to fuel use efficiency that are used in their networks.

Neither the Board nor railroad customers can be expected to have a sufficient grasp of railroad operations and fuel use factors to determine from the face of a fuel surcharge formula whether it reasonably reflects increased fuel costs; such knowledge resides with the railroads. Given the statutory mandate for this Board to “encourage honest and efficient management of railroads”, it certainly is reasonable for rail customers to expect and for this Board to require that railroads apply their expertise to incorporate accurate fuel use information in their fuel surcharge procedures. Honest management provides accurate information, and it is efficient to do so because of the avoidance of litigation that otherwise would be needed to provide a remedy if a railroad tries to take advantage of its superior knowledge about its own costs to mislead the customer. <sup>15/</sup> Thus, it would be both reasonable and feasible for the Board to require that

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<sup>15/</sup> Indeed, such an attempt almost certainly would run afoul of additional statutory goals administered by the Board, including “to limit the use of [rate] increases of general applicability” (Section 10101(10)) and “to ensure the availability of accurate cost information”. (Section 10101(13)).

railroads document and periodically update the rationale for the fuel-use parameters relevant to the specific rail surcharge mechanisms they employ.

#### SUMMARY AND CONCLUSIONS

For the reasons stated in AECC's opening Comments and in these Reply Comments, we propose that the Board:

1. Implement a true-up mechanism to correct for discrepancies that may arise between changes in actual unit fuel costs paid by railroads and unit prices indicated by the price index used to calculate fuel surcharges;
2. Allow exclusion of the mileage associated with circuitry attributable to such factors as nonissue traffic and carrier market power;
3. Exclude categories of fuel costs not directly variable with issue traffic;
4. Ensure implicit fuel economy estimates are adjusted over time to reasonably reflect ongoing fuel use efficiency improvements; and,
5. Allow exceptions for demonstrated variations in fuel-use intensity.

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Dated: October 15, 2014

**CERTIFICATE OF SERVICE**

I hereby certify that on this 15th day of October, 2014 I caused a copy of the foregoing document to be served electronically or by first class mail on all parties of record in this docket.

  
Eric Von Salzen