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BEFORE THE
SURFACE TRANSPORTATION BOARD

Rail Fuel Surcharges (Safe Harbor)	)))	Docket No. EP 661 (Sub-No. 2)

REPLY COMMENTS OF THE WESTERN COAL TRAFFIC LEAGUE, AMERICAN PUBLIC POWER ASSOCIATION, EDISON ELECTRIC INSTITUTE, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, SOUTH MISSISSIPPI ELECTRIC POWER ASSOCIATION AND CONSUMERS ENERGY COMPANY

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The Western Coal Traffic League ("WCTL"), American Public Power Association, Edison Electric Institute, National Rural Electric Cooperative Association, South Mississippi Electric Power Association and Consumers Energy Company (collectively "Allied Shippers") file these Reply Comments in response to the Surface Transportation Board's ("STB" or "Board") Advance Notice of Proposed Rulemaking ("ANPR") served in this proceeding on May 29, 2014 and in support hereof state as follows.

These Reply Comments address comments filed by the United States Department of Agriculture ("USDA"); National Industrial Transportation League ("NITL"); National Grain and Feed Association ("NGFA"); National Coal Transportation Association ("NCTA"); Consumers United For Rail Equity ("CURE"); Colorado Springs Utilities ("CSU"); Dow Chemical Company ("Dow"); Arkansas Electric Cooperative Corporation ("AECC"); Mercury Group ("Mercury Group"); Highroad Consulting, Ltd. ("Highroad"); BNSF Railway Company ("BNSF"); Canadian National Railway

Company ("CN"); CSX Transportation, Inc. ("CSXT"); and Union Pacific Railroad Company ("UP").

Allied Shippers' Reply Comments are supported by the Reply Verified Statement of Thomas D. Crowley, President of L. E. Peabody & Associates, Inc. and Robert D. Mulholland, Vice President of L. E. Peabody & Associates, Inc. ("Crowley/Mulholland Reply V.S.").[1]

PREFACE AND SUMMARY

In their Comments, Allied Shippers demonstrated that railroads were continuing to use their fuel surcharges as profit centers and requested that the Board propose a comprehensive set of rules to stop the profiteering. Other commenting shippers and USDA agree that carriers are continuing to use their fuel surcharges as profit centers and that comprehensive reform is needed.

BNSF, CN, CSXT, and UP (collectively "Railroads") take a different tact. They ask the Board to make no changes in the Board's current oversight of their railroad fuel surcharge programs. The Railroads' collective position is not surprising given the huge profits they are earning under the guise of fuel cost recovery, profits which run into the hundreds of millions of dollars annually, and multiple billions of dollars over time.

The Board is at a crossroads. The only way the Board can prevent continued carrier abuse of fuel surcharges is to adopt a comprehensive set of reform measures along the lines suggested by Allied Shippers in their Comments:

[1] Crowley/Mulholland's verified statement in Allied Shippers Comments shall be cited as "Crowley/Mulholland Opening V.S."

- Eliminate the current safe harbor treatment accorded the use of HDF prices.

- Require carriers that utilize fuel surcharges to base their fuel surcharge tables on changes in their actual fuel prices.

- Require each carrier that utilizes fuel surcharges to certify on an annual basis that (i) the fuel consumption factors in its fuel surcharge tables accurately reflect the fuel consumption on the traffic subject to the fuel surcharge; (ii) the revenues it is collecting under each fuel surcharge do not exceed the actual incremental fuel costs the carrier is incurring to provide the service subject to the fuel surcharge; and (iii) it is not engaged in any practices that elicit the double-recovery of the same incremental fuel cost changes.

- Require the certifications be accompanied by a report containing sufficient data and studies to permit the Board to audit and verify the carrier certifications.

If the Board does not institute comprehensive reform, it has two choices. One choice is to permit carriers to continue to engage in fuel surcharge practices that result in massive surcharge profiteering. This choice is directly at odds with the Board's overriding regulatory responsibility to ensure that carriers do not use their fuel surcharges as profit centers.

A second choice is to order carriers to phase-out permanent fuel surcharge tariffs, which would incent carriers to recover fuel costs in the manner Congress intended: through rate adjustment indices such as the Board-regulated Rail Cost Adjustment Factor ("RCAF"). This choice conforms to the Board's policy objectives by providing carriers with a means to recover – but not over-recover – their actual incremental fuel cost increases and is the policy choice Allied Shippers urge the Board to make if the Board decides not to effectively regulate carrier fuel surcharges.

ARGUMENT

I. OTHER SHIPPERS AND USDA AGREE WITH THE CONCERNS RAISED BY ALLIED SHIPPERS AND, LIKE ALLIED SHIPPERS, URGE THE BOARD TO ADOPT COMPRENSIVE REFORMS

The Comments filed by other shippers and USDA support the concerns raised by Allied Shippers and, like Allied Shippers, ask the Board to adopt comprehensive reform measures.

A. Carriers Continue to Use Their Fuel Surcharges As Illegal Profit Centers

The Board held in *Rail Fuel Surcharges III*[2] that rail carriers could not use their fuel surcharge programs as profit centers. Allied Shippers demonstrated in their Comments that, despite the Board's ruling, carriers are continuing to engage in unlawful fuel surcharge practices that permit them to reap hundreds of millions of dollars annually in unlawful profits.[3]

USDA, and other commenting shippers, expressed the same concerns. *See, e.g.*, USDA Comments at 5 (noting that "the Board's paramount objective in these proceedings" is "preventing fuel surcharges from becoming profit centers"); NGFA Comments at 9 (citing "the Board's paramount objective of preventing fuel surcharges from becoming profit centers"); NITL Comments at 8 ("carriers' fuel surcharge programs are generally over-recovering fuel costs"); CURE Comments at 2 ("the four major U.S. railroads' fuel surcharge programs are over-recovering their fuel cost increases"); Dow

[2] *Rail Fuel Surcharges*, STB Ex Parte No. 661 (STB served Jan. 26, 2007) ("*Rail Fuel Surcharges III*").

[3] *See* Allied Shippers Comments at 3-4.

Comments at 2 ("[p]ublicly available data raises serious questions about whether the significant revenue generated by [carrier] fuel surcharge programs is limited solely to recovery of incremental fuel cost incurred by the railroads (as shown in the railroads' own internal data)"; NCTA Comments at 1 (coal shippers are paying fuel surcharges "in excess of the fuel costs . . . [railroads] actually incur to provide this transportation"); Highroad Comments at 7 ("Historical data and cost evidence reveals the railroads continue to over-recover with their fuel surcharge programs").

B. Use of HDF Prices Produces Unlawful Profits

The Board's ANPR addressed one reason why fuel surcharge collections can exceed the carrier's actual incremental fuel cost increases: a positive spread differential between (i) the difference between the HDF price applied at the time of shipment and the carrier's actual fuel price at the time of shipment and (ii) the difference between the HDF strike price in the carrier's fuel surcharge table and the carrier's actual fuel strike price in the shipment base rate.[4]

The Board observed that in the *Cargill* case,[5] a positive spread differential resulted in BNSF collecting fuel surcharges on Ag and Industrial traffic during a five-year period that exceeded BNSF's actual incremental fuel costs for serving this traffic by over $181 million.[6] The Board asked, among other things, whether this spread

[4] *See* Allied Shippers Comments at 40 (citing an example where the time of shipment price difference was $0.81 per gallon, the strike price difference was $0.52 per gallon, and the resulting positive spread differential was $0.29 per gallon ($0.81- $0.52)).

[5] *Cargill, Inc. v. BNSF Ry.*, Docket No. NOR 42120 ("*Cargill*").

[6] ANPR at 2.

differential was a "unique situation affecting BNSF during a period of high price volatility."[7]

Allied Shippers demonstrated in their Comments that the positive spread differential that led to BNSF's collecting $181 million in surcharge-related profits was not a "unique situation." The spread differential has been trending positive for both BNSF and UP in most quarters since 1Q02 and has remained consistently – and substantially – positive since 1Q10, as shown in the table below:

Difference Between the Implicit Spread and the Actual Spread in the HDF Price
(cents per gallon)

Quarter	HDF	BNSF	UP
1Q10	284.8	28.8	8.8
2Q10	302.5	17.5	13.5
3Q10	293.9	23.9	9.9
4Q10	314.5	26.5	8.5
1Q11	362.6	39.6	14.6
2Q11	401.5	27.5	12.5
3Q11	386.7	17.7	8.7
4Q11	387.4	26.4	11.4
1Q12	397.1	32.1	14.1
2Q12	395.1	17.1	14.1
3Q12	394.1	29.1	15.1
4Q12	401.8	20.8	16.8
1Q13	402.9	29.9	19.9
2Q13	388.3	26.3	18.3
3Q13	391.1	22.1	14.1
4Q13	386.9	24.9	15.9
1Q14	395.9	32.9	23.9

Source: Crowley/Mulholland Opening V.S. Exhibit_(C/M-6)

The table shows that the actual spread differential between HDF price and railroad fuel price has been significantly and steadily greater than the spread implicit in

[7] *Id*. at 3.

the fuel surcharge program formulae.[8] When this happens, the railroads' surcharge programs falsely presume that their fuel costs are higher than they actually are. Allied Shippers demonstrated in their Comments that BNSF and UP were exploiting the spread differential to collect huge profits. In the last three years alone (2011 to 2013), BNSF collected spread-driven profits over $593,000,000 and UP collected spread-driven profits over $253,000,000.[9]

Allied Shippers were the only shippers to perform a *Cargill*-type spread differential analysis in their Comments. However, the USDA and other shippers agree with the conclusions Allied Shippers reached. *See*, *e.g.*, USDA Comments at 3 (the "spread between fuel costs and HDF Index is likely not an aberration"); NITL Comments at 7 ("The League believes that the information developed in the *Cargill* decision <u>by itself</u> leads to a rational conclusion that the EIA/HDF Index may not be accurately tracking incremental fuel expenses") (emphasis in original); Dow Comments at 8 ("[t]he evidence . . . strongly suggests that the phenomenon in *Cargill*. . . is not an aberration").

C. Use of Understated Fuel Consumption Factors Produces Unlawful Profits

Allied Shippers demonstrated in their Comments that a second reason why carriers are profiting from fuel surcharges is through their use of outdated and understated fuel consumption factors in their fuel surcharge tables. This has resulted in massive consumption-based overcharges.

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[8] There is insufficient public data to undertake a *Cargill*-type spread differential analysis for other Class I rail carriers. *See* Allied Shippers' Comments at 40.

[9] *See* Allied Shippers Comments at 45.

Carriers began publishing mileage-based fuel surcharges a decade ago and those tables contain implicit Miles Per Gallon ("MPG") fuel consumption factors in their "step functions."

Carrier	**MPG**	**Traffic**	**Tariff**	**Effective Date**
BNSF	4	Ag	6100-A, Item 3375-A	2006
BNSF	6	Coal	6100-A, Item 3381	2006
BNSF	4	Indus.	6100-A, Item 3375-A	2007
UP	5	Coal (CO/UT)	6602-C, Item 695	2007
UP	6	Coal (PRB)	6603-C, Item 695	2007
CSXT	4	ALL	8661-B	2007
CN	5.22	BULK	7402	2007
CN	5	NONBULK	7402	2007
CP	4.8	BULK	9700	2009
CP	4.4	NONBULK	9700	2009

See Allied Shippers Comments at 68.

However, carriers have not updated their fuel consumption factors to address the fact that their fuel consumption has improved, on average, by 20%, due to the introduction of new, more fuel efficient locomotives, the retirement of less fuel efficient locomotives, and the introduction of more fuel efficient operating practices.[10] Allied Shippers demonstrated that in 2013 alone, carriers' failure to use accurate, updated fuel consumption factors in their fuel surcharge tables generated huge surcharge profits: $150 million for BNSF; $180 million for UP; and $130 million for CSXT.[11]

Other commenters agree with Allied Shippers' concerns. *See, e.g.*, NITL Comments at 9 (Board should review "miles per gallon assumption[s]" in carrier fuel surcharge tables); NGFA Comments at 3 ("[d]uring the time span since fuel surcharges began to be assessed separately by the railroads . . . carriers have reduced their fuel costs

[10] Allied Shippers Comments at 70-72.

[11] *Id*. at 72.

by enhancing the efficiency of rail operations"); Mercury Group at 14 (citing "fuel efficiency" gains made by carriers "over [a] six year period (2008-2013)"); Dow Comments at 14 ("Many fuel surcharge programs have remained unchanged despite significant and ongoing fuel efficiency gains by the railroads"); CSU Comments at 6 ("If fuel efficiency has increased. . . without corresponding reductions in the quantity of fuel estimated under the fuel surcharge programs, then the surcharge formula likely overstates actual fuel usage").

D. Double Recovery Practices Produce Unlawful Profits

Allied Shippers demonstrated in their Comments that a third reason why carriers are profiting from fuel surcharges is through their use of a variety of double-recovery practices such as (i) setting a fuel surcharge trigger, or strike price, to kick-in when the actual price of fuel is low and then setting a base rate incorporating a substantially higher cost of fuel and (ii) adjusting base rates (which have fuel components) by an index such as the All-Inclusive Index Less Fuel ("AIILF") and applying a fuel surcharge to the base rate.[12]

Other commenters expressed concerns about double recovery practices. *See*, *e.g.*, USDA Comments at 3 (carriers can over-recover their actual fuel cost increases if they "have set the strike price too low") (footnote omitted); NITL Comments at 9 ("there are a number of other factors that might affect the reasonableness of a carrier's fuel surcharge, such as the strike price"); Highroad Comments at 12 (railroads may

[12] Allied Shippers Comments at 52-57.

engage in unreasonable actions if "[s]trike prices set by the railroads . . . [are] too low"); Dow Comments at 2 ("[t]he portion of total fuel costs recovered in a fuel surcharge can be increased simply by lowering the strike price").

E. The Necessary Remedies

In their Comments, Allied Shippers urged the Board to propose new rules to effectively regulate carrier fuel surcharge practices. Alternatively, Allied Shippers proposed that the Board order carriers to phase-out their fuel surcharge programs.

1. Effectively Regulate Fuel Surcharges

Allied Shippers asked the Board to adopt rules that would prevent carriers from using their fuel surcharges as profit centers. The USDA, and other commenting shippers, agree that the Board must adopt new rules and procedures designed to stop carriers from using their fuel surcharges as profit centers.

a. Eliminate the Safe Harbor

In *Cargill*, the Board interpreted its safe harbor ruling in *Fuel Surcharges III* as requiring the substitution of higher HDF prices BNSF did not pay for fuel, for the lower prices BNSF actually did pay for fuel, in determining BNSF's actual incremental fuel costs. The Board asked in the ANPR whether it should abolish the safe harbor.

The answer to this question is yes. As Allied Shippers explained in their Comments, the Board should abolish the safe harbor because the safe harbor, as applied in *Cargill*, undermined the Board's principal ruling in *Rail Fuel Surcharges III*: fuel surcharges should not be used as a profit center.[13]

USDA and other shipper commenters agree that the safe harbor should not be used to immunize carrier profiteering. *See* USDA Comments at 4 ("USDA believes the major shortcoming of the safe harbor is in granting immunity under certain scenarios for over recovery of fuel surcharges. Such immunity directly undermines the Board's paramount objective in these proceedings of preventing fuel surcharges from becoming profit centers . . . ."); NGFA Comments at 7-8 ("'safe harbor status should **not** immunize rail carriers from being challenged for setting fuel surcharges at levels that exceed the net incremental fuel costs actually incurred") (emphasis in original); Highroad Comments at 13 ("immunity" feature of safe harbor should be removed); CSU Comments at 10 ("A fuel surcharge program should not be afforded safe harbor status simply because it utilizes a specific index (i.e. the HDF Index)"); NITL Comments at 8 ("the League . . . strongly believes that it is not responsible or lawful for the Board to announce a 'safe harbor' and then ignore whether the central assumption underlying that safe harbor – that the EIA/HDF Index actually tracks the carriers' incremental cost of fuel is and remains true over time").

However, USDA and several other commenters expressed concerns that if the safe harbor is fully eliminated, carriers would have no STB-approved index to use in their fuel surcharge tables. *See, e.g.*, USDA Comments at 5 ("To eliminate the safe

[13] *See* Allied Shippers Comments at 35-36.

harbor would seem to indicate eliminating the HDF index, leaving rail carriers with no approved index on which to base their fuel surcharge programs."); NITL Comments at 8 ("the League has concerns with elimination of the safe harbor altogether, since it is very possible that carriers would return to the use of opaque and unjustified procedures in their fuel surcharge programs").

b. Use Actual Carrier Fuel Price Changes

In their Comments, Allied Shippers supplied the answer to concerns raised by some shippers concerning the absence of an STB-approved safe harbor index: the Board should direct carriers to use their actual railroad fuel price change increments in their fuel surcharge programs.[14] Use of actual price changes eliminates shipper concerns about matching an index with actual fuel price changes since actual price changes are directly incorporated into the fuel surcharge. Allied Shippers also demonstrated that use of actual fuel price changes meets all of the Board's fuel surcharge reasonableness standards: accuracy, credibility, feasibility/verifiability and timeliness.

- **Accuracy.** The result in *Cargill* confirms the obvious: the most accurate way to measure fuel price changes is to use the carrier's actual price changes, not changes from a surrogate index like HDF. Had BNSF's fuel surcharge table in *Cargill* used changes in actual BNSF fuel prices, instead of changes in HDF prices, the $181 million over-recovery on Ag and Industrial product shipments would not have

[14] *See* Allied Shippers Comments at 44.

occurred since the price component in BNSF's fuel surcharge tables would have been accurately calibrated.

- **Credibility.** After *Cargill*, shippers can have no faith that changes in HDF prices will yield accurate fuel surcharges. This result is buttressed by the Crowley/Mulholland analyses showing that the overcharge issue the Board identified in *Cargill* is not an aberration[15] and that there are wide swings for all major carriers between the absolute differences in HDF prices and fuel prices they actually pay.[16] Conversely, shippers can have faith that use of actual fuel price changes will yield accurate prices for fuel surcharge purposes.

- **Feasibility/Verifiability.** Use of actual prices is clearly feasible because carriers closely monitor their fuel prices.[17] Carriers can readily publish the actual prices they pay for fuel each month, and then use these price changes in their fuel surcharge. Indeed, given the availability of actual fuel price changes, "[t]here simply is no reason or need for the railroads to rely on a surrogate."[18] In addition, actual price changes are independently verified. Carriers already provide quarterly reports to the Board setting forth the actual prices they pay for fuel.[19] This data set necessarily contains

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[15] *See* Crowley/Mulholland Opening V.S. at 12-13.

[16] *Id*. at 18.

[17] *Id*. at 22.

[18] *Id*. at 20.

[19] All major carriers, except BNSF, also provide similar data on a quarterly basis to the Securities and Exchange Commission.

fuel price data on a monthly basis, so the Board could simply direct carriers to utilize the same actual price data set in their fuel surcharge programs.

- **Timeliness.** Carriers' use of actual price changes in their fuel surcharge tables should allow them to reach the 1-month lag target cited by the Board in *Rail Fuel Surcharges II.*[20] As Crowley/Mulholland point out, "[t]he railroads should have no problem turning around their monthly fuel price data in short order after the close of a given month," and as a result, ["t]he railroads could move to a one-month lag system rather than the current two-month lag system, which would likely lead to better alignment between incremental fuel costs and fuel surcharges."[21]

c. Use Accurate Fuel Consumption Factors

Allied Shippers also emphasized in their Comments that simply eliminating the safe harbor, and directing carriers to use actual fuel price changes in their fuel surcharge tables was not enough. The Board also needs to address the carriers' use of outdated and understated fuel consumption factors.[22] Other commenters agree. *See, e.g.*, USDA Comments at 6 (Board must address "the nexus between fuel consumption and fuel surcharges"); NITL Comments at 9 ("In addition to determining the accuracy of the EIA/HDF Index, the Board should consider other fundamental elements of the carriers' fuel surcharge programs"); NGFA Comments at 8 (the Board needs to address whether there is "a reasonable nexus between [carrier] fuel surcharge formulas and their actual

[20] *Rail Fuel Surcharges*, Ex Parte No. 661, slip op. at 6 (STB served Aug. 3, 2006) ("*Rail Fuel Surcharges II*").

[21] Crowley/Mulholland Opening V.S. at 22.

[22] Allied Shippers Comments at 76.

incremental fuel costs"); CSU Comments at 10 (STB should address "the actual quantity of fuel implied by the surcharge program"); Dow Comments at 16 (Board should review "the step function"); Mercury Group at 13 ("fuel efficiency should be incorporated into future rules").

d. Eliminate Double Recoveries

In their Comments, Allied Shippers requested that the Board address double recovery practices.[23] Again, other commenters agreed. *See, e.g.*, USDA Comments at 5 (Board must review whether a fuel surcharge is "appropriately calibrated to a suitable starting period that acts as an accurate reference point"); NITL Comments at 9 (Board should consider carrier "strike price" assumptions); Dow Comments at 16 (Board must review carrier "strike price" assumptions).

e. Order Additional Reporting and Certifications

Currently, the Board engages in no meaningful oversight of carrier fuel surcharge programs. Oversight is left to shippers, who must file complaints challenging the legality of individual carrier fuel surcharge programs. Allied Shippers explained in their Comments that the Board is unlikely to see any more shipper complaints due to the regulatory hurdles the Board has imposed on shippers attempting to pursue these cases. These hurdles include the need to show that entire fuel surcharge programs are unlawful, not just that a carrier is collecting unreasonable fuel surcharges on the complainant

[23] *Id*. at 77.

shipper's traffic. Allied Shippers requested that the Board reverse course, and place affirmative duties on carriers to demonstrate their fuel surcharges are reasonable.[24]

USDA and other commenters agree that the Board must take a more pro-active role and require carriers to demonstrate their fuel surcharge practices are reasonable. *See, e.g.*, USDA Comments at 6 ("relying on . . . lengthy rate complaints to gauge the reasonableness of fuel surcharge programs with the actual cost of fuel will insulate rail carriers from compliance with the Board's directive" that carriers not use fuel surcharges as profit centers); NITL Comments at 8-9 ("it should be incumbent on the rail carriers to justify the reasonableness of their fuel surcharge programs and shippers should not be required to engage experts and incur high legal and economic consultant costs to determine a fair, accurate and appropriate" fuel surcharge); Dow Comments at 16 ("[t]he time is appropriate for the Board to engage in a more searching review of fuel surcharge programs").

In their Comments, Allied Shippers proposed that, in addition to ordering carriers to use actual prices in their fuel surcharge tables, the Board require carriers to affirmatively demonstrate each year that they were not engaged in unlawful fuel surcharge practices. Allied Shippers specifically proposed that this affirmative demonstration take the form of three annual carrier certifications, along with accompanying reports:

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[24] *See* Allied Shippers Comments at 59-63; 75-76.

- A certification that the fuel consumption factors in its fuel surcharge tables were accurate, along with a report containing sufficient information to audit the certification.

- A certification that the revenues collected under each fuel surcharge tariff did not exceed the carrier's actual incremental fuel cost increases incurred in providing the service subject to the tariff, along with a report containing sufficient information to audit the certification.

- A certification that the carrier was not engaged in any form of fuel cost double recovery, along with a report containing sufficient information to audit the certification.[25]

Other commenters proposed similar forms of affirmative demonstrations and reports:

- **USDA**. "USDA believes the best way to prevent [carrier use of fuel surcharges as profit centers]. . . is to make additional information available through the Quarterly Reports of Fuel Surcharges to include total revenue allocated to fuel costs collected through the base rate, total internal fuel costs, the difference between internal fuel costs and the amount collected through fuel surcharge revenues, and any other such information. . . . In the case where the rail carrier has over recovered its fuel costs, these should be returned to shippers by some means such as a credit on fuel costs in subsequent periods or through direct payments." USDA Comments at 6.

- **NITL**. NITL asks the Board to "commit to an ongoing review, perhaps once every two or three years," of carrier fuel surcharge practices and "[a]s part of this proceeding, the Board should request the carriers to provide additional data where it is needed . . . to ensure that the Board has accurate information to conduct its analyses on an ongoing basis." NITL also emphasizes that in these review proceedings, the Board "should require the carriers to justify – up front – the reasonableness of . . . key assumptions used in their overall fuel surcharge program." NITL Comments at 9-10.

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[25] Allied Shippers Comments at 76-77.

> ● **NGFA**. NGFA recommends that the Board require carriers to include in their Quarterly Report of Rail Fuel Surcharges "for each major commodity group (e.g., agricultural products, chemicals, coal, etc.), as follows: 1) total fuel costs already recovered through their respective base-rate structures; 2) the difference between internal fuel costs recovered through base-rate structures and the amount collected through fuel surcharge revenues; and 3) any other relevant information." NGFA Comments at 8 (emphasis in original).
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> ● **Dow.** "The Board may want to consider a process whereby the railroads or their industry association could make regular filings (every two or three years, for example) at the Board to show that their fuel surcharge programs appropriately recover only their internal incremental fuel costs. The filings could be open for comment just as the cost of capital filings of the Association of American Railroads are open for comments in Ex Parte No. 558. After receiving comment, the Board could issue a decision on the fuel surcharge mechanisms used by the railroads." Dow Comments at 17.
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> ● **CSU.** "[T]he STB should review all attributes of a fuel surcharge program and require the railroads to demonstrate that the surcharge program design, how it is being applied, the fuel use, and the incremental revenue collected, are reasonable." CSU Comments at 10.

Allied Shippers' proposals are more comprehensive than those presented by USDA and other commenters as they directly address the problem that led to the $181 million over-recovery in *Cargill* – the mismatch between changes in HDF prices and actual carrier fuel prices – and remediate the problem with the obvious solution: requiring carriers to use their actual fuel price changes in their fuel surcharge tables.

Allied Shippers' proposals also contain elements that build on those presented by other commenters. For example, USDA and NGFA correctly emphasize that the purpose of a fuel surcharge is to recover incremental fuel cost increases, and the only way incremental fuel cost increases can be measured is by requiring carriers to disclose not just the total fuel surcharges being collected, but the amount of fuel recovery in the base rates. Allied Shippers' proposals incorporate this concept into their annual reporting requirements, but add to it, by requiring carriers to provide sufficient data for the Board and the public to audit base rate fuel recovery. In addition, Allied Shippers' proposals directly address related problems identified by many commenters: the need for accurate fuel consumption factors in fuel surcharge tables and the need to stop impermissible double recovery practices.

2. If Permanent Fuel Surcharges Are Not Effectively Regulated, They Should Be Phased-Out

Allied Shippers also asked the Board to order the phase-out of fuel surcharges if the Board decides not to effectively regulate them.[26] In support of this request, Allied Shippers described in detail the evolution of rail regulation of carrier fuel surcharges.[27] This evolution is not complicated.

Prior to the Staggers Act,[28] fuel surcharges were disfavored and heavily regulated to insure they were limited to cost recovery. Congress expressed displeasure with fuel surcharges in the Staggers Act, and directed the STB to replace fuel surcharges and other forms of general rate increases. The ICC responded by developing the RCAF, an index that the STB regulates and which permits full fuel cost recovery. Following the adoption of the RCAF, fuel surcharge tariffs were seldom used until the railroad industry

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[26] Allied Shippers Comments at 78-81

[27] *Id*. at 10-18.

[28] Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 ("Staggers Act").

decided to resurrect them in the early 2000's. As Allied Shippers emphasized, this resurrection "was a major step backwards in the evolution of railroad pricing."[29]

Other commenters agreed with Allied Shippers' concerns. *See* Highroad Comments at 19 ("since the railroad fuel surcharge programs are no longer needed and have developed into nothing more than revenue enhancement programs, [] they should be terminated"); CURE Comments at 14 ("Railroads have gotten away from an escalation method for fuel and other rail costs that had oversight at the STB (RCAF Index) and switched to escalating fuel through surcharges that have little or no oversight at the STB. That has been a great trade-off for railroads, but it has become very costly for rail shippers.")

II. THE RAILROADS' FAILED ATTEMPTS TO DEFEND THEIR FUEL SURCHARGE PRACTICES

Four carriers submitted comments: BNSF, CN, CSXT and UP. Not surprisingly each carrier defends the status quo because each is profiting from it. However, none offer credible arguments to support their continued profiteering at the expense of the shipping public.

A. BNSF's Failed Attempt

BNSF argues that the Board should retain the safe harbor and make no other changes in its current oversight of rail fuel surcharge practices because (i) in *Rail Fuel Surcharges*[30] shippers "generally supported the use of the HDF index in rail fuel

[29] Allied Shippers Comments at 78.

[30] *Rail Fuel Surcharges*, STB Ex Parte No. 661.

surcharges;"[31] (ii) the spread between HDF prices and BNSF's actual fuel prices led only to a "modest" overcharge in *Cargill*;[32] (iii) the Board's analysis in *Cargill* was flawed because it failed to "consider the substantial costs incurred by BNSF in its various fuel-efficiency initiatives;"[33] (iv) the spread between HDF prices and BNSF's actual fuel prices which occurred during the 2006 to 2010 time period "is no longer a concern since the HDF index and BNSF's internal fuel prices have moved . . . in tandem since 2010;"[34] and (v) "eliminating the safe harbor may push railroads to consider eliminating fuel surcharges or [to] use their internal fuel price data as the basis for calculating fuel surcharges."[35] Allied Shippers' response follows.

- **Shipper Support.** Rail shippers' principal concern in *Rail Fuel Surcharges* was that railroads were using their fuel surcharge programs as profit centers. They asked the Board to take actions to stop the profiteering. Many, but not all, shippers supported the use of HDF prices in rail fuel surcharge tables based on their belief at the time that use of HDF would not itself be a source of profiteering. But, after *Cargill*, shippers now know better. Thus, the pertinent inquiry is what shippers know now, not what they did not know before *Cargill*. Moreover, some shippers in the 2006-2007 proceedings, including WCTL, did not favor the use of any index. Instead, they argued

[31] BNSF Comments at 4.

[32] *Id*. at 2.

[33] *Id*.

[34] *Id*. at 2-3.

[35] *Id.* at 3.

that if the Board permitted fuel surcharges, then fuel surcharge tables should be based on actual fuel price changes:

> [B]ecause data on the carriers' actual change in fuel prices is readily available, and it is a simple process to utilize this information in accounting for changes in railroad fuel prices, it is not necessary for the Board to require carriers to utilize a third-party fuel price index.[36]

The time has come to do so.

- **Spread Differential**. A $181 million overcharge is far from "modest," as the Board itself found in *Cargill*. *See Cargill III*,[37] slip op at 14 (finding the $181 million overcharge "not . . . insubstantial"). The $181 million overcharge also was just the tip of the iceberg. The total constituted the overcharge under one BNSF tariff, applicable to specified commodities. Allied Shippers conservatively estimate the spread differential on all BNSF carload, and coal, traffic over the last three years alone (2011 to 2013) has generated profits over $593,000,000.[38] These are substantial monies which grow every day.

- **Capital Investments.** The purpose of a fuel surcharge is to capture incremental fuel cost increases. It is not a bottomless pit to recover carrier capital investments. BNSF can, and does, recover its capital investments in its base rates. These rates are very high; BNSF is earning record profits; and, indeed, is earning so much it

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[36] *Rail Fuel Surcharges*, Ex Parte No. 661, Comments of the WCTL at 17 (filed Oct. 2, 2006).

[37] *Cargill, Inc. v. BNSF Ry*., Docket No. NOR 42120 (STB served Aug. 12, 2013) ("*Cargill III*").

[38] *See* Allied Shippers Comments at 45.

was recently found "revenue adequate" by the Board.[39] Shippers are not required to pay for capital investments twice, which is why the Board limits fuel surcharges to fuel cost increases.

- **Steady Spread.** The "spread" between HDF and BNSF's actual price changes has not been as volatile in recent years as it was between 2006 and 2010 but, as Crowley/Mulholland emphasize, that is beside the point because BNSF's profiteering continues unabated:

> As shown in our Opening Exhibit (C/M-3), the BNSF surcharge programs are calibrated on the presumption that the spread between HDF and BNSF fuel prices equal $0.52 per gallon. However, in 2011 through 2013, the spread between HDF and BNSF fuel prices –the period BNSF identifies as relatively more stable than during the 2006-2010 time period on a month to month basis – were $0.78 per gallon on average. BNSF therefore enjoyed a $0.26 per gallon advantage, and used it to overcharge its customers by over half-a-billion dollars.[40]

- **Surcharge Elimination.** The public interest is best served if carriers stop using fuel surcharges. There is no need for them, and they are used as a means to hide profiteering under the guise of cost recovery.

B. CN's Failed Attempt

CN argues that the Board should make no changes in its fuel surcharge policies because (i) "[t]he essential rationale and necessity for fuel surcharges – the

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[39] *See Railroad Revenue Adequacy – 2013 Determination,* Docket No. EP 522 (Sub-No. 18), slip op. at 1-2 (STB served Sept. 2, 2014).

[40] Crowley/Mulholland Reply V.S. at 5-6.

volatility of fuel prices– remains;"[41] (ii) since 2Q08, "changes in the HDF index and in CN's average fuel costs have generally tracked closely;"[42] (iii) "CN's [sic] does not view and has not sought to use its fuel surcharge program as a profit center;"[43] and (iv) "no surcharge approach based on an index can be perfect."[44]

- **Volatility.** CN's assertion of volatility is directly at odds with BNSF's contrary assertion. But the correct question is not whether fuel prices are currently volatile or not volatile. The question is whether a carrier's fuel surcharge program is reasonable under all market situations, including times when fuel prices are volatile and times when they are not.

- **Spreads.** CN's spread argument is similar to BNSF's argument: shippers should have no concerns because its fuel price changes have closely tracked changes in HDF prices in recent years. That assertion does not address the key question raised in *Cargill*: whether the implicit spread between the railroad's fuel prices and the HDF strike price are exceeded by the spread between the railroad's fuel prices and the HDF strike price at the time of shipment. As Allied Shippers discussed in their Comments, CN has never publicly disclosed the actual fuel price embedded in its base

[41] CN Comments at 3.

[42] *Id*.

[43] *Id*. at 4.

[44] *Id*.

rates, so neither Allied Shippers, nor the Board, can undertake a *Cargill*-type spread analysis for CN.[45]

- **Profitability.** Like CN, BNSF claimed in *Cargill* that its intent was not to use its fuel surcharge as a profit center, even though its fuel surcharge program was clearly functioning as a profit center.[46] Intent is not the important issue here. The issue is whether CN and other carriers' fuel surcharge programs act as profit centers. Such practices are inherently deceptive, regardless of a carrier's subjective intent, because fuel surcharges can only be legally used to recover incremental fuel costs.

- **Perfection.** *Cargill* teaches that surrogate indices are a poor substitute for the use of actual fuel price changes in fuel surcharge tables. The Board should order carriers that choose to use fuel surcharges to use actual fuel cost changes to calibrate their fuel surcharges, a procedure that will achieve the best match between actual fuel cost changes on the cost side and actual fuel cost changes on the revenue collection side.

C. CSXT's Failed Attempt

CSXT devotes its comments to re-litigating issues the railroad industry lost in *Rail Fuel Surcharges*. According to CSXT, "[u]nder the statutory regime enacted by Congress and authoritatively interpreted by federal courts, a shipper that believes the rail

[45] *See* Allied Shippers Comments at 40.

[46] *See Cargill III*, slip op. at 17.

common carrier rates it has paid are unreasonable (including fuel surcharges or any other component of such rates) may bring a rate case."[47]

CSXT's premise is of course incorrect. The Board considered and rejected arguments made by CSXT that it had no authority to take actions to prevent carriers from using their fuel surcharges as profit centers. In *Rail Fuel Surcharges III*, the Board held that use of fuel surcharges for "revenue enhancement measure[s]" was "a misleading and ultimately unreasonable practice:"

> [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. . . . We believe that imposing rate increases in this manner, when there is no real correlation between the rate increase and the increase in fuel costs for that particular movement to which the surcharge is applied, is a misleading and ultimately unreasonable practice.[48]

The Board should decline CSXT's invitation to revisit its principal holding in *Rail Fuel Surcharges III* – it is an unreasonable practice for carriers to use their fuel surcharges as profit centers.

D. UP's Failed Attempt

UP argues the Board should not modify or remove the "HDF Index Safe Harbor" because (i) shippers "overwhelmingly supported" the use of HDF in 2006/2007;[49] (ii) use of HDF "continues to be 'a reasonable index to apply to measure

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[47] CSXT Comments at 2.

[48] *Rail Fuel Surcharges II*, slip op. at 7.

[49] UP Comments at 2.

changes in fuel costs;'"[50] (iii) since the spread is subject to "high variability, there is no obvious way to predict whether the average spread will increase or decrease from one month to the next;" and (iv) the "benefits of retaining the HDF Index Safe Harbor outweigh the Board's concern about changing spreads."[51]

- **Shipper Support.** UP's shipper support arguments are identical to the arguments made by BNSF. As demonstrated above, not all shippers supported the use of the HDF index, and, more importantly, most shippers did not envision that use of that index would serve to insulate carriers from liability if they used the HDF index in a way that generated substantial profits for the carrier, while giving the railroads flexibility to modify their fuel surcharge formulae if the HDF index resulted in under recovery of incremental fuel costs.

- **Reasonable Results.** UP's use of the HDF Index has not produced reasonable results. Its surcharge program is based on a presumed static spread of $0.60 per gallon between HDF prices and its actual fuel prices, but the actual spreads have been significantly higher and, as a result, "UP has over-collected over a quarter-of-a-billion dollar in revenues on unit coal train and carload traffic between 2011 and 2013."[52]

- **Variability**. UP's variability arguments ignore the significant spread advantage it has today. As Crowley/Mulholland emphasize:

> UP has a $0.17 [per gallon] spread advantage today. Thus, the spread could be reduced by $0.10 per gallon, and UP would still

[50] *Id*. at 9 (internal quotation marks omitted).

[51] *Id*.

[52] Crowley/Mulholland Opening V.S. at 7.

> be taking advantage of a $0.07 per gallon favorable spread. Conversely, if the spread were to increase by $0.10 per gallon, UP would benefit from a $0.27 per gallon favorable spread.[53]

- **Costs/Benefits.** The safe harbor should not be retained because it defeats the purpose of the Board's overriding goal in regulating fuel surcharges: preventing the surcharge programs being used as profit centers. In addition, the public interest in having an accurate, transparent, and neutral means of measuring fuel price changes can be achieved if carriers base their fuel surcharge tables on changes in their actual fuel prices. *See* Allied Shippers Comments at 43-50.

III. THE BOARD SHOULD INCLUDE ALLIED SHIPPERS' REMEDIAL PROPOSALS IN A NOTICE OF PROPOSED RULEMAKING

Allied Shippers request that the Board proceed to issue a notice of proposed rulemaking in this proceeding containing the following proposals:

- The safe harbor treatment accorded the use of HDF prices will be eliminated.

- Carriers that utilize fuel surcharges must base their fuel surcharge tables on changes in their actual fuel prices.

- Each carrier that utilizes fuel surcharges must certify on an annual basis that (i) the fuel consumption factors in its fuel surcharge tables accurately reflect the fuel consumption on the traffic subject to fuel surcharge; (ii) the revenues it is collecting under each fuel surcharge do not exceed the actual incremental fuel costs the carrier is

[53] Crowley/Mulholland Reply V.S. at 3.

incurring to provide the service subject to the fuel surcharge; and (iii) it is not engaged in any practices that permit the double recovery of the same incremental fuel cost changes.[54] The certifications will be accompanied by a report containing sufficient data and studies to permit the Board to audit and verify the carrier certifications.

Allied Shippers believe that if the Board proposes, and adopts, this set of rules, the Board can effectively regulate carrier fuel surcharge practices. However, if the Board decides not to effectively regulate fuel surcharge practices, it should propose to phase-out permanent fuel surcharge tariffs.

CONCLUSION

Allied Shippers request that the Board take actions that are consistent with the views set forth in its Comments and Reply Comments.

Respectfully submitted,

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Dated: October 15, 2014

[54] This certification should include an affirmative statement that the strike price used to develop the fuel cost component of the base rate is the same as the fuel surcharge program kick-in fuel price.

BEFORE THE
SURFACE TRANSPORTATION BOARD

RAIL FUEL SURCHARGES (SAFE HARBOR)	)	**Docket No. EP 661 (Sub-No. 2)**

Reply

Verified Statement

Of

Thomas D. Crowley

President

And

Robert D. Mulholland

Vice President

L. E. Peabody & Associates, Inc.

On Behalf Of

Allied Shippers

Filed: October 15, 2014

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I. INTRODUCTION

We are Thomas D. Crowley and Robert D. Mulholland. We are the same Thomas D. Crowley and Robert D. Mulholland that submitted an Opening Verified Statement in this proceeding on August 4, 2014. Copies of our credentials are included as Exhibit No. 1 and Exhibit No. 2 to our Opening Verified Statement ("Opening VS"), respectively. Our Opening Verified Statement addressed specific issues raised by the Surface Transportation Board ("STB" or "Board") in its May 29, 2014 decision in this proceeding.[1]

We have been requested by Counsel for Allied Shippers to address the railroads' opening comments also filed on August 4, 2014.

UP, BNSF, CN, and CSXT filed Opening Comments urging the Board to retain the current safe harbor provision. The railroads' arguments overlapped to some degree. The issues addressed by the railroads and the results of our review are summarized in the remainder of this Reply Verified Statement and are organized under the following topical headings:

II. Historical Justifications for Using the HDF Index are no Longer Valid

III. Timeliness, Accuracy, Transparency, Availability and Neutrality

IV. Other Issues Raised by the Railroads

[1] STB Docket No. EP 661 (Sub-No. 2), *Rail Fuel Surcharges (Safe Harbor Provision)*, served May 29, 2014 ("*Safe Harbor*").

II. HISTORICAL JUSTIFICATIONS FOR USING THE HDF INDEX ARE NO LONGER VALID

The railroads all point to comments made by shippers and other parties during the 2006 Ex Parte 661 (Sub-No. 1) proceeding which contained general agreement that HDF had reasonably tracked railroad fuel prices in the preceding years as proof that the HDF is a reasonable proxy for railroad fuel.[2]

However, the railroads' reliance on historical support from shippers in order to perpetuate the use of HDF is irrelevant. Indeed, even if nearly all parties believed HDF would closely track railroad fuel prices into the future a decade ago, that presumption was proven to be wrong over the last decade, and the unexpected divergence resulted in systematic over-recovery of fuel costs.

We now have the benefit of experience to correct this over-recovery problem moving forward. However, the railroads resist such reforms in their Opening Comments notwithstanding the continuing over-recovery of fuel costs. For example, UP acknowledges that from 2007 through 2014, "the average spread slowly crept above the level that existed when UP established its mileage-based HDF surcharge."[3] In fact, as shown in our Opening Exhibit (C/M-3), the spread had increased by $0.17 per gallon for UP by 2013. This results in roughly a $0.03 per car-mile overcharge, which nets UP approximately $100 million in excess fuel surcharge revenues per year.

UP claims that because there is a possibility that the spread could "move back towards earlier levels… the concern expressed in the Board's Advance Notice that the safe harbor provision could give the railroads the 'unintended advantage' of being able to

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2 See, e.g., CSXT Opening Comments at p. 4 and CN Opening comments at p. 2.
3 UP Opening Comments, pp. 8-9.

alter their fuel surcharge programs to take advantage of the spread is unwarranted."[4] However, UP's position is untenable. First, the unpredictability of the future spread between HDF and railroad fuel prices is precisely why the fuel surcharge programs should be based on railroad fuel prices and not HDF. Second, it is just as likely that the spread will continue to increase as it is that the spread will decrease. But the starting point is no longer neutral. UP has a $0.17 spread advantage today. Thus, the spread could be reduced by $0.10 per gallon, and UP would still be taking advantage of a $0.07 per gallon favorable spread. Conversely, if the spread were to increase by $0.10 per gallon, UP would benefit from a $0.27 per gallon favorable spread.

The railroads have known about the advantage they have gained from the divergence for years and have not acted to recalibrate their program formulae to correct the resulting over-recovery. UP acknowledges a very simple and obvious action it could have taken at any time, i.e., periodically rebasing its fuel surcharge programs. UP claims that it has not done so because, "frequent rebasing would be guaranteed to create significant administrative costs for both railroads and shippers, who would have to reprogram billing, budgeting, and forecasting systems to reflect new rate and fuel surcharge levels, with little or no benefit."[5]

UP's justification for inaction is disingenuous. The rebasing adjustment is so simple it could be done overnight. The mechanics are set forth below:

- UP presumed spread = $0.60 per gallon
  - UP carload surcharge program HDF kick-in price = $2.30
  - UP PRB coal surcharge program HDF kick-in price = $1.35
- UP 2013 observed spread = $0.77 per gallon
- UP 2013 spread advantage = $0.77 - $0.60 = $0.17 per gallon

4 UP Opening Comments, p. 9.
5 UP Opening Comments, p. 10.

- UP adjusted carload program HDF kick-in price = $2.30 + $0.17 = $2.47
- UP PRB coal program HDF kick-in price = $1.35 + $0.17 = $1.52

No accompanying adjustments to the base rates would be required to implement this change, so the only thing UP and the other railroads that have enjoyed such an advantage would need to do is send smaller (and more accurate) surcharge bills to shippers. Shippers would bear no administrative cost and would clearly benefit from paying only for the incremental cost of fuel. This adjustment could easily be made on an annual basis with very little effort. The railroads' refusal to act requires that the Board step-in to ensure that the programs act as cost recovery mechanisms and not profit centers over the next decades.

III. TIMELINESS, ACCURACY, TRANSPARENCY, AVAILABILITY, AND NEUTRALITY

A. TIMELINESS

As discussed in our Opening comments, the railroads fuel surcharge programs generally apply the HDF price to determine fuel surcharges with a two-month lag. Fuel surcharges are ostensibly required to allow the railroads to recover fuel-related costs in a timely manner. A two-month lag can hardly be called timely, and the railroads possess, and could easily publish, their internal fuel price data in a far timelier manner, thereby reducing the lag to one month.

B. ACCURACY

The railroads generally concede that HDF prices have not been very accurate in terms of approximating railroad fuel prices for the last decade. For example, BNSF acknowledges that the Board "noted that differences between the HDF index and BNSF's internal fuel prices over the *Cargill* analysis period had produced a divergence between BNSF's fuel surcharge revenues and its incremental fuel costs."[6] BNSF claims that the market conditions during the *Cargill* study period of 2006-2010 were unusual, the markets have since stabilized, and since 2011, "the HDF index has closely tracked changes in BNSF's internal fuel price."[7] However, BNSF completely ignores the fact that the spread between HDF and railroad fuel prices has increased significantly since the period during which the implicit spread underpinning all of its fuel surcharge programs was determined.

As shown in our Opening Exhibit (C/M-3), the BNSF surcharge programs are calibrated on the presumption that the spread between HDF and BNSF fuel prices equal

[6] BNSF Opening Comments, p. 2. See also UP Opening Comments, pp. 8-9.
[7] BNSF Opening Comments, p. 1.

$0.52 per gallon. However, in 2011 through 2013, the spread between HDF and BNSF fuel prices—the period BNSF identifies as relatively more stable than during the 2006-2010 time period on a month to month basis—were $0.78 per gallon on average. BNSF therefore enjoyed a $0.26 per gallon advantage, and used it to overcharge its customers by over half-a-billion dollars.[8]

Despite the many years of persistent over recovery of fuel costs, BNSF claims in its Opening Comments that its spread advantage is "no longer a concern."[9] BNSF goes so far as to state that the Board's concerns over abuse of the safe harbor are based on "a misplaced concern about a limited divergence between the public HDF index and a railroad's internal fuel costs that appears to have been the product of circumstances during a specific time period."[10] BNSF's bold misrepresentation of the extent to which it continues to take advantage of the favorable spread divergence is exactly why the Board should act to correct the issues we identified in our Opening Comments. Simply put, BNSF's spread advantage will persist unless the market changes suddenly and significantly in favor of shippers, or the BNSF fuel surcharge programs are revised.

CSXT also takes a strident position on the issue of accuracy. Specifically, CSXT states:

> "The recent unreasonable practices challenge brought by shipper Cargill regarding a rail carrier's fuel surcharge program, and the Board's disposition of that challenge, demonstrated that the safe harbor provision is working as it was designed…. That case provides no reason to revisit the safe harbor provision of the Board's fuel surcharge rules."[11]

8 See Opening Exhibit(C/M-3).
9 BNSF Opening Comments, p. 2.
10 BNSF Opening Comments, p. 3.
11 CSXT Opening Comments, p. 1.

CSXT's position disregards the Board's finding that BNSF demonstrably over-recovered incremental fuel costs during the study period—even using BNSF's own calculations—*because* it was protected by the safe harbor provision. BNSF *took advantage* of the safe harbor provision to over-recover costs with impunity.

C. TRANSPARENCY

The railroads claim that HDF prices are transparent. However, for reasons pointed out in our Opening VS, the fuel surcharge programs are not transparent overall, because only a portion of the fuel surcharge formula is based on the HDF price. The formula also reflects a presumption that the internal railroad fuel strike-price is equivalent to the HDF price at which the surcharge program kicks-in. This information is known only to the railroads. If a disconnect exists between the railroad strike-price and the HDF kick-in price, then the whole surcharge program is calibrated incorrectly. Shippers have no way of knowing this unless the carriers publicly disclose both the railroad strike price and the analyses the railroads undertook to determine the "equivalent" HDF price used in the fuel surcharge formula, and many carriers have chosen no to do so.

Additionally, the fuel surcharge programs are based on a presumed static average fuel consumption rate that is reflected in the length of the step function. The railroads possess data regarding their fuel consumption rates, and know those rates are improving, but have not undertaken any efforts to revise their surcharge step functions to reflect the improvements, thus leaving shippers in the dark concerning the correct relationship between the fuel surcharges they are paying and the carriers' actual fuel consumption.

Furthermore, BNSF notes that one of the intended benefits of using a "publicly available and clear" index was to ensure that all parties would be "in a position to assess the reasonableness of any fuel surcharges that result."[12] However, the Board's decision in *Cargill* demonstrated that while shippers may be able to assess the reasonableness of fuel surcharges, they have no recourse because the safe harbor allowed BNSF to keep $181 million in fuel surcharge revenues it had overcharged shippers.

D. AVAILABILITY

The railroads claim that HDF is a good surrogate index because it is publicly available and it is as good as any other publicly available price to use as a proxy for railroad fuel prices. However, the only reason monthly railroad fuel prices are not publicly available is that the railroads elect not to publish them. The solution to that is simple: require the publication of monthly railroad fuel price data. The railroads already publish their fuel price data on a quarterly basis, so publishing monthly data is not a burden. Alternatively, the programs could use the public quarterly prices as the basis for the surcharges, which should not be a significant obstacle because the programs already have a two month lag.

E. NEUTRALITY

As discussed above, the railroads possess data regarding the internal strike prices they use to set base rates, their fuel consumption rates, and their monthly fuel prices. In addition, the railroads possess the ability to conduct studies to determine whether the use of HDF as a price proxy is beneficial or detrimental to them, which they do conduct. For example, BNSF changed its fuel surcharge programs in 2011 "after lengthy monitoring of the performance of the fuel surcharge program and planning for change."[13] The railroads have the ability to alter their fuel surcharge programs based on analysis of data they possess. This is in no way neutral, since shippers lack access to most of the key data,

[12] BNSF Opening Comments, p. 5, citing the US DOT.
[13] BNSF Opening Comments, p. 13.

and, of course, in the absence of Board intervention, only the railroads can make changes to their fuel surcharge programs.

Furthermore, the way BNSF changed its fuel surcharge program is particularly troubling. The Board found in *Cargill* that the central problem with the fuel surcharge was that the spread between HDF and BNSF fuel prices had increased in favor of BNSF. The solution to this problem is simple; reset the HDF kick-in rate to reflect the "new normal" spread. The mechanics are set forth below:

- BNSF presumed spread = $0.52 per gallon
  - BNSF surcharge program HDF kick-in price = $1.25
- BNSF 4Q2010 observed spread = $0.785 per gallon
- BNSF 4Q2010 spread advantage = $0.785 - $0.52 = $0.265 per gallon
  - BNSF adjusted program HDF kick-in price = $1.25 + $0.265 = $1.515

This change would have adjusted the fuel surcharge to eliminate the safe harbor-related windfall, and it would have been applied to the same base rates as the original fuel surcharges. The net effect would have been to reduce the overall amount shippers were charged to eliminate the safe harbor-related windfall.

Instead, BNSF opted to continue its over-recovery of fuel costs, except it pushed that over recovery into the base rates. Specifically, in January 2011, BNSF rebased its fuel surcharge programs so that the HDF kick-in price was increased to $2.50 per gallon from $1.25 per gallon. However, BNSF stated that the change was made "so that the fuel surcharge would be a much smaller portion of a shipper's all-in transportation price."[14] Therefore, the effect of the "rebasing" was not to recalibrate the formula to account for the increased spread between HDF and BNSF fuel prices and *reduce the amount of over-recovery*, as the adjustment shown above would have done. Rather, the effect of BNSF's

[14] BNSF Opening Comments, p. 9.

rebasing exercise was to redistribute much of the fuel surcharge over-recovery into the base rates, while recovering the same amount of revenue in total as it had recovered before the surcharge was rebased.

Assume BNSF's pre-rebasing base rate was $1,000 per car on a 400-mile carload shipment, with $73 attributable to fuel at BNSF's $0.73 per gallon strike-price.[15] Further assume that BNSF was set to collect $0.48 per loaded car-mile on carload shipments based on the November 2010 HDF price of $3.140.[16] This amounts to $192 in fuel surcharges per car, for a total of $1,192 per car.[17] When BNSF rebased its fuel surcharge program, it simply recalculated the fuel surcharge at a $2.50 per gallon kick-in price, or $0.17 per loaded car mile.[18] At 400 miles, this equates to $68 per car in rebased fuel surcharges. The rebased fuel surcharges were determined to be $124 less per car than the fuel surcharges under the previous program, so *the base rate was increased by $124 per car* to $1,124. Therefore, after rebasing the fuel surcharge, the base rate plus fuel surcharges remained $1,192 per car.[19]

However, the initial BNSF fuel surcharge of $0.48 per gallon was overstated by $0.265 per gallon based on the fact that the actual 4Q2010 spread was $0.785,[20] not the presumed $0.52.[21] As a result, the initial fuel surcharge should have been $0.41 per car-

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15 400 loaded car-miles at 4 loaded car-miles per gallon = 100 gallons consumed, at $0.73 per gallon.

16 $0.01 per loaded car-mile for every $0.04 above $1.25 HDF.

17 $1,000 + ($0.48 x 400).

18 $0.01 per loaded car-mile for every $0.04 above $2.50 HDF.

19 $1,124 + $68.

20 The November spread cannot be determined from public data because BNSF's November fuel price is not published. However, the November 2010 HDF price was $3.140 and the 4Q2010 HDF price was nearly identical at $3.145, so a comparison of the 4Q2010 BNSF price to the 4Q2010 HDF price is used here for demonstrative purposes.

21 Based on the presumed $0.52 per gallon spread, the initial BNSF surcharge program assumed the BNSF internal fuel price was $3.145 - $0.52 = $2.625. However, BNSF reported its actual 4Q10 fuel price as $2.36.

mile rather than $0.48.[22] For the example carload movement, this would result in $28 per carload in incremental fuel cost over-recovery through the fuel surcharge program attributable to $0.265 in spread divergence.[23] When BNSF rebased its fuel surcharge program, it essentially moved this over-recovery from its fuel surcharge into its base rates. Because BNSF elected to rebase its fuel surcharge program during a period of very favorable spread divergence, the over-recovery is now included in the reissued base rates. Even if BNSF were to recalibrate its new fuel surcharge program to better align its HDF kick-in with its strike price, that redistribution has been captured permanently. Plainly, the FSC programs are not neutral, even if the HDF Index is used.

[22] $2.36 + $0.52 = $2.88. At $2.88 HDF, the fuel surcharge is $0.41, compared to $0.48 at $3.145 HDF.
[23] $0.07 x 400 = $28.00.

IV. OTHER ISSUES RAISED BY THE RAILROADS

The railroads raised a number of additional issues in their Opening comments that we address below under the following topical headings:

A. Universal Index

B. Close Correlation

C. Ease of Application

D. Shipper Recourse

A. UNIVERSAL INDEX

The railroads point to shippers' desire for railroads to use a single universal index in their programs (citing shippers' comments in EP 661).[24] However, the railroads' fuel surcharge formulae are calibrated based on railroad-specific fuel consumption rates (i.e., step functions) and railroad-specific strike prices and kick-in price points. Therefore, it only makes sense to use railroad-specific fuel prices as well. The various programs result in different surcharges from railroad to railroad within a given month already, so consistency and accuracy demand they reflect the correct prices. Moreover, a universal index is only useful if it produces accurate results over time, which the HDF Index did not do.

B. CLOSE CORRELATION

The railroads claim that because there is a close historical correlation between HDF and railroad fuel prices, HDF is a good proxy for railroad fuel prices in the fuel surcharge formula.[25] However, as discussed in our Opening VS,[26] prices that are well correlated in terms of relative (i.e., percent) change over time are not necessarily good

[24] See, e.g., UP Opening Comments at p. 5 and BNSF Opening Comments at p. 4.
[25] See UP Opening Comments at p. 7.
[26] See Crowley/Mulholland Opening Verified Statement, p. 16.

substitutes for one another in terms of measuring absolute change. The railroads' fuel surcharge formulae universally use absolute change in HDF as a proxy for absolute change in railroad fuel price. Because we know the price spread has increased substantially despite strong correlation, the correlation defense cited by the railroads is irreparably flawed.

C. <u>EASE OF APPLICATION</u>

The railroads opine that the current programs should be retained because they are easy to apply and well understood by shippers. However, increasing accuracy through using real data need not make the surcharge any more complicated or difficult to understand. It simply requires that the various fuel surcharge tables be updated from time-to-time and rebased to actual monthly rail fuel prices rather than surrogate HDF prices. Thus, all that is needed is for railroads to replace or adjust the critical variable inputs into the various FSC programs. Specifically, there are three critical variable inputs:

1. *Fuel price*: The programs currently use HDF price but should use railroad-specific fuel prices, which the railroads could easily publish on a monthly basis.

2. *Fuel strike-price*: The programs currently use a set HDF price that the railroads represent to be "equivalent" to the railroads' internal strike-price. However, the railroads generally do not disclose their internal strike-prices and none offer any concrete proof that the so-called equivalent HDF price was fairly derived initially or is periodically reviewed and validated. The railroads should disclose their internal strike-price and use it as the starting point for their surcharge programs.[27]

3. *Fuel consumption rates*: The programs generally use round numbers in their step functions to approximate their fuel consumption rates. However, the railroads are constantly improving their fuel efficiency and have not updated their step functions to pass the efficiency gains

[27] To further improve transparency, railroads should identify the portion of the base rate attributable to fuel for all shipments subject to fuel surcharges.

> onto shippers. The railroads should be required to disclose their fuel consumption rates and periodically update their step functions to reflect efficiency gains realized from their acknowledged "various fuel-efficiency initiatives, including the purchase of fuel-efficient locomotives."[28]

Updating the critical variable inputs to reflect actual railroad fuel prices and consumption rates would be a straightforward undertaking that would immediately improve the accuracy and transparency of the programs without creating "new" FSC programs thereby keeping confusion to a minimum.

D. SHIPPER RECOURSE

UP argues that eliminating the safe harbor would "create unfair asymmetry" and that with the "benefit of hindsight, shippers readily could file claims when changes in the indices overstated changes in rail fuel prices, secure that railroads could not file claims when the situation was reversed."[29] UP's argument is red herring. It is the safe harbor that, unintentionally or not, created unfair asymmetry. More importantly, the railroads have never needed to and should never need to file claims against shippers, because the railroads control the surcharge formula and program structure and all of the data required to evaluate the programs on an ongoing basis. If changes in the indices understated changes in rail fuel prices, the railroads could—and can—adjust their programs to ensure cost recovery. Shippers have no recourse when the situation is reversed because the railroads' decision to adjust their surcharge programs is discretionary, and the safe harbor shields the railroads from any obligation to do so when the index divergence is favorable to them.

CSXT argues that the Board should only be concerned with fuel surcharges as applied to regulated shipments; that surcharges should be considered part of the overall

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[28] BNSF Opening Comments, p 2.
[29] UP Opening Comments, p. 11.

rate; and that captive shippers should resort to filing maximum rate cases at the STB if they believe their total base rates plus fuel surcharges are too high. This argument was rejected by the Board in *Rail Fuel Surcharges*. The Board held in that case that a carrier engages in an unreasonable practice if it uses its fuel surcharges as profit centers.[30]

[30] STB Ex Parte No. 661 (Sub-No.1), *Rail Fuel Surcharges*, served January 26, 2007 at 7-8.