

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 661

RAIL FUEL SURCHARGES

Decided: August 3, 2006

Due to widely voiced public concerns, we held a public hearing on May 11, 2006, to inquire as to the fuel surcharge practices employed by the railroad industry for purportedly recouping their rapid increases in costs for fuel. In particular, we inquired into the carriers' practice of applying fuel surcharges that are computed as a percentage of the base rate. We also inquired into the various means the railroads employ to measure increases in their cost of fuel. We received extensive testimony on these issues from the rail industry, the public, and the customers that the railroads serve. Based on this record, we propose to adopt several measures regarding railroad practices involving fuel surcharges.

First, a carrier wishing to assess what purports to be a fuel surcharge would need to develop a means of computing the surcharge that is more closely linked to the increases in the portion of its fuel costs that is attributable to the movement to which the fuel surcharge is applied. Second, carriers would be prohibited from "double dipping" by charging for the same increases in fuel costs for the same shipment both through a fuel surcharge and through application of a rate escalator that is based on an index such as the Board's Railroad Cost Adjustment Factor (RCAF) without first subtracting out any fuel cost component from that index. Third, railroads would be required to use a single, uniform index for measuring increases in the fuel costs—the Energy Information Administration (EIA) "U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon)." Finally, each Class I railroad would submit a monthly report to the Board showing its actual total fuel costs, total fuel consumption and total fuel surcharge revenues, as well as how much of its total fuel surcharge revenues are shared with its shortline connections. We seek public comment on these proposals.

BACKGROUND

At the hearing we asked interested parties to address: (1) whether fuel surcharges are being applied in such a manner as to limit their use to recovering increases in the cost of fuel for the particular movement to which the surcharge is applied; and (2) whether and how reporting should be adjusted to provide the Board and rail customers with better information on a carrier's fuel costs and the revenues collected through its fuel surcharges. We heard from numerous shippers, railroads, associations, consultants, and elected officials.

The shipper community expressed deep dissatisfaction with the railroad industry's methods of assessing fuel surcharges. Shippers recognize that railroads are entitled to recover the increased costs they incur from the rising price of fuel. However, most take issue with the manner in which fuel surcharges are generally being imposed — as a percent of the base rate.¹ They maintain that fuel surcharges that are tied to the level of the base rate bear no direct relationship to actual fuel consumption² and are instead used as a “profit center.”³ Many shippers also allege that railroads are “double dipping,” i.e., recovering the same fuel cost increases twice — by applying both a fuel surcharge and a rate escalation clause based upon an index such as the RCAF without first subtracting out the component of the index for fuel cost increases.⁴ In addition, several shippers maintain that railroads are relying on inappropriate, inflated indices for calculating the increases in the costs of fuel that they incur.⁵ Finally, shippers argue nearly unanimously that transparency is needed for rail fuel surcharges. They ask the Board to require railroads to regularly report their fuel costs and their revenue from fuel surcharges.⁶

Each Class I railroad participated in this proceeding. They largely concede that their fuel surcharges are not tied to the fuel consumption associated with the individual movements to which they are applied. However, most claim that, when their systems are examined as a whole,

¹ BNSF Railway Company was commended by some shippers for having recently employed a fuel surcharge system for grain and coal movements based on mileage rather than the level of the base rates.

² See, e.g., testimony of Alliance of Automobile Manufacturers (Alliance), Ag Processing Inc. (AGP), Ameren Energy Fuel and Services Company (Ameren), Concerned Captive Coal Shippers (Concerned Coal Shippers), American Chemistry Council (ACC), Transportation Economics, Inc., and Escalation Consultants, Inc. (Escalation Consultants)). Shippers such as National Industrial Transportation League (NITL) argue that linking fuel surcharges to freight rates creates significant inequities.

³ See, e.g., testimony of U.S. Senator Byron Dorgan, U.S. Senator Conrad Burns, Graniterock, The Fertilizer Institute (TFI), AGP, Total Petrochemical USA Inc. (TPI), Ameren, the Western Coal Traffic League (WCTL), National Grain and Feed Association (NGFA), Concerned Coal Shippers, North Dakota Grain Dealers Association (NDGDA), Wheat and Barley Commissions, NITL, Diversified CPC International, Inc., and the U.S. Department of Agriculture (USDA).

⁴ See testimony of Senator Dorgan, TFI, AGP, Griffin Industries, Inc., Degussa, WCTL, Arkansas Electric Cooperative Corp (AECC), ACC, Edison Electric Institute (EEI), NITL, Escalation Consultants, and the AES Corporation.

⁵ See, e.g., testimony of Alliance, AGP, Ameren, WCTL, AECC, and NDGDA.

⁶ See, e.g., testimony of Alliance, TFI, Transportation, Elevator, and Grain Merchants Association, Ameren, WCTL, NGFA, Concerned Coal Shippers, NDGDA, Wheat and Barley Commissions, ACC, NITL, Escalation Consultants, and Freight Resources Network, LLC.

they are not recovering the full increase in the cost of their fuel. That appears to be because railroads cannot apply fuel surcharges to every customer, and therefore, in order for the railroads to recover their full additional fuel costs, some shippers are charged surcharges that are greater than the actual incremental cost of the fuel used for their particular shipments. The railroads argue that their fuel surcharges are, nevertheless, fair, equitable, and, most significantly, easy to administer.

Finally, there is some concern that shortline and regional railroads are not receiving a fair share of the fuel surcharges collected for movements in which they participate.⁷ For example, the Oil Creek & Titusville Lines, Inc. (Oil Creek), claims that Norfolk Southern Railway Company applies fuel surcharges to interline movements but does not pass on an appropriate share of surcharge revenues to junction settlement carriers.

DISCUSSION AND CONCLUSIONS

Board Authority Over Fuel Surcharge Practices

A key requirement of the Interstate Commerce Act, as amended by the ICC Termination Act of 1995, is that a railroad's common carrier rates and practices be reasonable. 49 U.S.C. 10701(a), 10702. While the Board's authority to address the reasonableness of a railroad's rates is limited to traffic over which the railroad has "market dominance,"⁸ 49 U.S.C. 10701(d)(1), there is no such limitation over its authority to address the reasonableness of a railroad's practices.

Some railroad interests have claimed that the Board does not have authority to regulate fuel surcharges, absent a finding of market dominance, because fuel surcharges are part of the total rate charged and thus cannot be considered as a practice. They cite Union Pacific R.R. v. ICC, 867 F.2d 646, 649 (D.C. Cir. 1989), where the Board's predecessor, the Interstate Commerce Commission (ICC), had concluded that certain railroads engaged in an unreasonable practice by attempting to avoid their common carrier duty to transport radioactive waste through increased rates designed to recover cost additives that the ICC regarded as unwarranted. 867 F.2d at 648. The reviewing court recognized that there can be a "conceptual overlap between railroads' 'practices' and their 'rates.'" 867 F.2d at 649. The court nonetheless struck down the ICC's action because the "so-called 'practice' [was] manifested exclusively in the level of rates," the ICC's analysis had "all the earmarks of a rate proceeding," and the ICC's remedies consisted of rate relief (prescribed rates and refunds). Id. (emphasis in original).

⁷ See, e.g., testimony of NDGDA.

⁸ "Market dominance" is defined as "an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies," 49 U.S.C. 10707(a).

Here, however, we are not proposing to limit the total amount that a carrier can charge, through a combination of base rates and surcharges, for providing rail transportation. Rather, we are only addressing what we believe is an unreasonable practice of applying what the railroads label a fuel surcharge in a manner that is not limited to recouping increased fuel costs that are not reflected in the base rate. The measures we are proposing are designed to preclude such an unreasonable practice.⁹

Linkage Requirement

The carriers concede that most of their fuel surcharges are calculated as a percentage of the base rate. The record before us indicates that there is little, if any, correlation between an increase in the cost of fuel for an individual rail movement and the level of the base rate for that movement. To the extent that a base rate is cost-based, it reflects substantial costs, including the costs of labor and of capital investments, that do not track rapid changes in fuel costs. And while fuel costs represent a significant expense for railroads, they are nonetheless a comparatively small part of a carrier's total costs.

More importantly, a railroad's base rates are not entirely cost-based. Rather, railroads can and do engage in demand-based differential pricing, which means that they apply higher mark-ups over costs to their captive traffic than to traffic with transportation alternatives. See Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 526-28 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). Moreover, the level of a railroad's base rates can vary significantly depending upon the value of the commodity being shipped and the type of handling that is required. Thus, tying the amount of a fuel surcharge to the level of the base rate means that even two shippers that have shipments moving over the same route between the same points could be charged vastly different fuel surcharges, notwithstanding the fact that the fuel costs associated with their movements could be identical. And it means that a short-haul captive shipper would pay a much higher fuel surcharge than a longer-haul competitively served shipper of the same commodity even though the total fuel costs for the captive shipper's movement would be less because of the differential pricing of the base rates.

In short, because differences in base rates are not pegged primarily to differing fuel costs, we do not believe that it is a reasonable practice for railroads to compute fuel surcharges as a percentage of existing rates. A carrier should not identify a surcharge as a cost-recovery mechanism for a discrete portion of its costs unless the surcharge is directly tied to and limited to the incremental changes in that particular cost for the movements to which the surcharge is applied. In other words, railroads should not call a charge a fuel surcharge if it is designed to

⁹ We may adopt rules of general applicability for future conduct to address an unreasonable practice, even though our authority to award shipper-specific remedies is limited to a formal complaint proceeding. Cf. Mr. Sprout, Inc. v. United States, 8 F.3d 118, 128-29 (3d Cir. 1993) (citing with approval ICC rules governing carrier processing of claims for loss or damage to cargo, even though such claims could only be resolved in another forum).

recover more than the incremental cost of fuel attributable to the movement involved.¹⁰ We therefore admonish carriers to reexamine their method of calculating fuel surcharges.

We propose to require that fuel surcharges be tied not to the level of the base rate but to those attributes of a movement that directly affect the amount of fuel consumed: either mileage alone or, preferably, weight and mileage. Railroads would have discretion to devise an alternative methodology, so long as it would have a reasonable nexus to the fuel consumption for the movement involved.

We recognize that when the ICC examined fuel surcharges in the 1970's, it declined to require the railroads to apply a mileage-based surcharge, because the ICC was concerned that such a requirement "would cause more problems than it would solve." Expedited Procedures for the Recovery of Fuel Costs, 350 I.C.C. 563 (1975). Conditions, however, have changed since 1975. At that time rates were more often cost-based, whereas now railroads typically use demand-based pricing. Thus, a fuel surcharge tied to the level of the base rate today affects shippers in a significantly different manner than it did in 1975. Moreover, applying a mileage or ton-mile approach would not be as burdensome on railroads today as it would have been in 1975, given the railroads' greater electronic information management capabilities.¹¹

Double Dipping Prohibition

Some carriers escalate their base rates using an index such as the RCAF, which the Board publishes on a quarterly basis. The RCAF, as its name implies, seeks to measure increases in costs that the railroad industry incurs. It includes changes in the cost of fuel as a component of the index. It is possible that some carriers have been charging twice for the same fuel cost increases, by both escalating the base rate using such an index (without first subtracting out the fuel cost component) and applying a fuel surcharge.¹² We believe that engaging in such "double dipping" would also be an unreasonable practice, and we propose to prohibit the use of a fuel surcharge to recover increases in fuel costs to the extent those same increased costs are also recovered through the application of an escalator to the base rate that incorporates changes in fuel costs.

¹⁰ Cf. Rate Bureau Agreements – EC-MAC Motor Carrier Service Assoc., et al., 5 S.T.B. 1065 (2001) (conditioning continuation of antitrust immunity for motor carrier rate bureaus on a "truth-in-rates" notice on every freight bill).

¹¹ We note that this proposal does not address the level of the base rates. Whether the surcharge, together with the base rate, produces a charge that is excessive is an issue that can only be addressed on a case-by-case basis upon a rate complaint by a captive shipper. We do not have the authority, as some shippers have suggested, to order carriers to roll back charges across the board.

¹² See, e.g., testimony of AES Corporation.

Railroads could continue to collect a fuel surcharge if they remove the fuel cost component from the RCAF (or other index) used to escalate the base rate. That approach would have the advantage of avoiding the longer time lag for recovery that is associated with the quarterly RCAF, in favor of a fuel surcharge that is adjusted more rapidly.

Appropriate Index of Fuel Cost Increases

To assist us in monitoring fuel surcharge practices, we propose to require all Class I railroads to use a single, uniform index to measure increases in fuel costs. Therefore, we have reviewed the available options and propose adoption of an index that we believe is more suitable. We believe the best index available is the EIA's "U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon)." EIA is an independent statistical arm of the Department of Energy, created by Congress for the express purpose of providing policy-neutral data and forecasts. The index we propose to adopt is the most broad based fuel index published by EIA. In addition, the index is consistent with other fuel indices. It has a .997 correlation with the EIA Refiner Prices of Petroleum Products to End Users and has a .998 correlation with the Association of American Railroads' fuel cost index. Finally, there is minimal lag in this index. It is available with a 1-month lag,¹³ whereas other indices can lag 2 or 3 months behind the cost increases they measure.

Reporting

The final measure that we propose is reporting that would allow the Board and affected shippers to better monitor railroads' fuel surcharge practices. We believe that this is so important that we are asking each Class I railroad to voluntarily provide this information while we are conducting this proceeding. Specifically, each Class I railroad should report, on a monthly basis, its total expenditures for fuel, the total gallons of fuel it consumed, the increase or decrease in its cost of the fuel from the previous month, its revenue tons for the month, and its revenue tons to which the fuel surcharge was applied. We also request that each Class I railroad voluntarily report the revenue it collects on joint shipments with Class II and Class III carriers, and report the revenues from fuel surcharges shared with Class II and Class III carriers. The proposed monthly reporting form is appended to this decision.

The unprecedented increase in the price of fuel has placed a tremendous burden on all sectors of our economy. Those who must bear that burden, whether it be the users of rail service or the members of the public who ultimately pay the costs, are entitled to understand the process of assessing those costs and apportioning them. The rate payers and the public are entitled to have that process carried out in a rational and equitable manner, and the disclosure of the information we seek is a necessary step in that process.

¹³ <http://tonto.eia.doe.gov/dnav/pet/hist/ddr001M.htm>

Otherwise Exempted Traffic

Under 49 U.S.C. 10502(a), the Board (like the ICC before it) has broad discretion to exempt entire categories of traffic from the regulatory provisions of the Interstate Commerce Act. The ICC and Board have exercised that discretion to exempt various broad classes of traffic from such regulation. See 49 CFR Part 1039. The Board retains the discretion, however, to revoke those exemptions to the extent it finds necessary to achieve the regulatory objectives of the statute. 49 U.S.C. 10502(d).

The concerns we have about the reasonableness of the railroads' fuel surcharge practices apply equally to the classes of traffic that have been exempted under section 10502 and the measures we are proposing here should therefore apply to those classes of traffic as well. Therefore, we propose to partially revoke those exemptions to the extent necessary to apply the measures outlined here to the classes of traffic identified at 49 CFR part 1039.

We believe that our obligation to promote the regulatory objectives of the statute, as articulated in the rail transportation policy (RTP) at 49 U.S.C. 10101 supports such a partial revocation here. Paragraph (9) of the RTP—which states that, in regulating the railroad industry, it is the policy of the United States Government to encourage honest and efficient management of railroads—supports prohibiting the misleading practice of assessing fuel surcharges that are computed as a percentage of the base rate. Paragraph (9) also supports a prohibition against double dipping. Paragraph (13) of the RTP—which states that it is the policy of the United States Government to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on the rail carriers of developing and maintaining the capability of providing such information—supports the collection from railroads of accurate information on their fuel costs and the revenue they generate from fuel surcharges. Finally, paragraph (14)—which provides that, in regulating the railroad industry, it is the policy of the United States Government to encourage and promote energy conservation—supports the requirement to use a more appropriate fuel cost index, as well as the other three measures proposed here. Together they would tie the burden of paying for increased fuel costs more directly to the activities that consume the fuel. Ensuring that added fuel costs are borne by those for whom the fuel is consumed is an essential ingredient in any attempt to conserve this limited resource. Thus, while we do not believe these actions would have a substantial effect on the conservation of energy resources, any effect they might have should be beneficial.

Request for Comments

We seek comments from all interested parties on the proposals set out herein. Those comments are due within 45 days of publication of notice of this decision in the Federal Register.

This action should not significantly affect the quality of the human environment.

It is ordered:

1. Comments are due on September 25, 2006.
2. This decision is effective on the date of service.

By the Board, Chairman Buttrey and Vice Chairman Mulvey.

Vernon A. Williams
Secretary

APPENDIX**RAILROAD NAME _____****MONTHLY REPORT OF****FUEL COST, CONSUMPTION AND FUEL SURCHARGE REVENUES****FOR THE MONTH OF _____, 20__****Instructions**

The report shall contain data for on the current month only. Cost and revenues are defined as accrued or earned this month. The report shall be filed with the Surface Transportation Board on or before 20 days after the end of the month.

LINE NO	Report all data in thousands (a)	(b)
1	Total fuel ¹	
2	Gallons of fuel consumed	
2	Increased or decreased cost of fuel ²	
3	Revenue from fuel surcharges ³	
4	Revenue from fuel surcharges collected on joint shipments with Class II and III railroads	
5	Revenue reported in line 4 from fuel surcharges shared with Class II and III railroads	

¹ Includes freight, yard and work train locomotives, but not passenger locomotives. Show cost of fuel charged to train and yard service (function 67-Loco. Fuels). Include all other fuel used for railroad operations and maintenance, including motor vehicles and power equipment not charged to function 67-Loco. Fuels (calculate the cost consistent with the instructions for function 67).

² Show the total increase or decrease in fuel cost over previous month. That is, the average per unit increased or decreased cost times the number of units used.

³ Show the total revenue from fuel surcharges.

6	Ton-miles of freight revenue - road service fuel surcharge applied to ⁴	
7	Total ton-miles of freight revenue – road service	

⁴ Show the revenue tons to which the fuel surcharge was applied.