BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 661 (Sub.No.2)

RAILROAD FUEL SURCHARGES (SAFE HARBOR)

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REPLY COMMENTS OF HIGHROAD CONSULTING, LTD.

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1.0 INTRODUCTION.

Highroad Consulting, Ltd. submits this response to comments presented at the above-captioned proceeding, and we will present additional justification for our request for a full review of the railroads' fuel surcharge programs, as detailed in our submission, dated August 4, 2014.

The Board initiated this rulemaking proceeding to allow shippers, rail carriers, and other interested parties the opportunity to comment on whether the Safe Harbor provision of the Board's current fuel surcharge rules should be modified or removed. The Board sought comments from the public on five key questions:

1. Should the Safe Harbor provision of Fuel Surcharges be modified or removed?
2. Are there problems associated with the Board's use of HDF as a Safe Harbor to judge the reasonableness of fuel surcharge programs?
3. Can any of the problems with the Safe Harbor be addressed through modification of it?
4. Is the phenomenon observed in Cargill an aberration?
5. Are the problems with safe harbor outweighed by its benefits?

However, the Board also encouraged parties to comment on any other matter that they believe bears on whether the Safe Harbor should be removed or modified.[1]

The railroads' fuel surcharge programs are problematic and do not comply with the Board's directive to calculate surcharges that more closely link to the portion of the fuel costs attributable to the movement.[2] The HDF Index increased at a greater rate than railroad fuel costs so application of the Safe Harbor allows the railroads to

[1] STB Decision Docket No. EP 661 (Sub-No. 2), May 29, 2014, p. 3.
[2] STB Decision Docket No. EP 661, January 25, 2007, p. 2.

continue to over-recover with their fuel surcharge programs. The Safe Harbor relieves the railroads from the responsibility to assess fuel surcharges that are fair and accurate. Still, addressing only the Safe Harbor is not the solution - that would only be a Band-aid approach and would not address the numerous problems associated with the fuel surcharges.

The fuel surcharges warrant a full review which is the reason we are asking the Board to re-open *Ex Parte No. 661, Railroad Fuel Surcharges* ("*Fuel Surcharge*").

2.0 CARGILL WAS NOT AN ABERRATION, THE RAIL CARRIERS CONTINUE TO OVER-RECOVER WITH THEIR FUEL SURCHARGE PROGRAMS.

In our statement filed on August 4, 2014, we presented cost information that revealed fuel surcharge revenues have increased at a greater rate versus the railroads' fuel costs. Thus, a logical question is, if HDF accurately tracks changes in the railroads' fuel costs, how did this happen?

The Mercury Group, in their submission, explained that the safe harbor does not anticipate changes in both public policy and technology that further limit the ability of DOE Index based programs to accurately reflect market rail diesel costs, and they listed several emerging trends in energy and transportation that should be considered for future rulemaking:

- Changes in on-highway fuel tax rates and policies.
- Potential regulations and market shifts relating to climate change and emissions.
- Growth of alternative fuels in rail transportation.[3]

Examples of other fuel efficiency initiatives adopted by the railroads include shutting down idling locomotives, acquisitions of more fuel efficient locomotives, and

[3] EP 661 (Sub-No. 2), Initial Comments of The Mercury Group dated July 11, 2014, pp. 9 – 13. Examples of other fuel efficiency initiatives adopted by the railroads include shutting down idling locomotives, acquisitions of more fuel efficient locomotives, and distributed power,

distributed power. The fact is, diesel costs have declined since the railroads modified their fuel surcharge programs and rolled fuel surcharge revenues into the rates.

For this filing, we developed additional evidence that all of the railroads are over-recovering with their fuel surcharge programs. We used a simplified fuel cost-only version of Highroad's INSIGHT: RailEdition© cost model to produce cost data on fuel. Fuel costs reported in the model are based on the railroads' own R1 data (adjusted quarterly via the RCAF). Fuel costs are divided into those costs affected by the gross ton-mileage (e.g. road fuel costs) and those affected more by switching efficiency (e.g. yard fuel costs).

It has been our experience that the railroads have rolled fuel surcharge revenues into the rates upon the adoption of new fuel surcharge schedules or tariffs. Therefore, since the surcharges are not to include fuel costs imbedded in the rates, the fuel surcharge programs should be rebased and fuel surcharges should only reflect incremental cost increases or decreases in the diesel fuel price from the date of the revised fuel surcharge index or tariff.

To calculate the change in fuel cost for a given lane, we compared the current cost to the cost at the adoption of each railroad's current fuel surcharge index (e.g. 2011 for BNSF's $2.50-base surcharge). We then took the current fuel surcharges, applied them to the sample lanes' mileages, and examined the differences between fuel surcharges and actual cost increases.

For this study, we used generic car statistics – 66,000 lb. tare weights with lading weights of 30 and 100 tons. Costs were developed for shipments of 100-ton and 30-ton cars via BNSF, CN, CPRS, CSXT, KCS and UP at different mileage increments (500, 1000, 1500 and 2000 miles). Our work papers will be provided to the Board if requested.

Shown below is a summary of the overcharges per mile based on fuel surcharges that apply on carload traffic in October 2014:

TONS	MILEAGE	OVERCHARGE/MILE					
		BNSF	CN	CPRS	CSXT	KCS	UP
30	500	$ 0.2128	$ 0.3610	$ 0.2885	$ 0.3029	$ 0.3468	$ 0.2063
	1000	$ 0.2248	$ 0.3619	$ 0.2920	$ 0.3295	$ 0.3583	$ 0.2412
	1500	$ 0.2288	$ 0.3622	$ 0.2931	$ 0.3384	$ 0.3621	$ 0.2529
	2000	$ 0.2308	$ 0.3624	$ 0.2937	$ 0.3428	$ 0.3640	$ 0.2587
100	500	$ 0.0602	$ 0.4398	$ 0.1940	$ 0.1720	$ 0.2658	$ 0.1288
	1000	$ 0.0722	$ 0.4407	$ 0.1975	$ 0.1986	$ 0.2773	$ 0.1638
	1500	$ 0.0762	$ 0.4410	$ 0.1986	$ 0.2074	$ 0.2811	$ 0.1754
	2000	$ 0.0782	$ 0.4411	$ 0.1992	$ 0.2119	$ 0.2830	$ 0.1812

It is also important to consider the fact that some of the railroads' fuel surcharge programs have been in effect for more than seven years. Therefore, it is reasonable to assume that fuel costs would have increased over time absent a fuel crisis. Therefore, we performed a second analysis, factoring in the normal cost of inflation, and the overcharges are even greater. The mileage based fuel surcharges that apply on carload traffic in October 2014 are:

BNSF	$0.34	CSXT	$0.44
CN	$0.31	KCS	$0.43
CPRS	$0.34	UP	$0.35

The table below shows the overcharges after factoring in the normal cost of inflation.

TONS	MILEAGE	OVERCHARGE/MILE WITH INFLATION					
		BNSF	CN	CPRS	CSXT	KCS	UP
30	500	$ 0.2344	$ 0.4155	$ 0.3173	$ 0.3439	$ 0.3932	$ 0.2786
	1000	$ 0.2446	$ 0.4104	$ 0.3187	$ 0.3686	$ 0.4038	$ 0.3011
	1500	$ 0.2479	$ 0.4087	$ 0.3192	$ 0.3769	$ 0.4073	$ 0.3086
	2000	$ 0.2496	$ 0.4078	$ 0.3194	$ 0.3810	$ 0.4091	$ 0.3124
100	500	$ 0.1085	$ 0.5521	$ 0.2581	$ 0.2686	$ 0.3808	$ 0.2622
	1000	$ 0.1186	$ 0.5471	$ 0.2595	$ 0.2933	$ 0.3914	$ 0.2847
	1500	$ 0.1220	$ 0.5454	$ 0.2599	$ 0.3016	$ 0.3949	$ 0.2922
	2000	$ 0.1237	$ 0.5445	$ 0.2601	$ 0.3057	$ 0.3967	$ 0.2960

If the overcharges were eliminated, it would nearly eradicate the fuel surcharges.

Typically, the lighter loads show greater overcharges – while one fuel surcharge is applied to all traffic on the basis of mileage, it doesn't account for the lesser fuel burn on lighter traffic. One exception to this rule is CN, whose road fuel costs dropped significantly between institution of the current fuel surcharge and the present. However, CN's yard fuel didn't see such a drop, and these factors in combination invert the overcharge effect.

3.0 THE RAILROADS' FUEL SURCHARGE PROGRAMS HAVE DEVELOPED INTO REVENUE ENHANCEMENT PROGRAMS.

The Board set forth in their decision that the term "fuel surcharge" suggests a charge to recover increased fuel costs associated with the movement to which it is applied, but fuel surcharges are not to be used as a rate increase mechanism.[4]

However, it has been our experience when working for numerous clients, that railroad sales and marketing personnel consider the fuel surcharges to be an integral

[4] STB Decision Document, EP_661_0, January 25, 2007, pp. 5 – 6.

part of the carriers' revenue requirements and the "base rates." This has been apparent on numerous occasions.

One example was a Highroad client who was in the final negotiations with a carrier for a multi-year rate and service contract. After the rates were agreed to, our client requested application of the mileage based fuel surcharge instead of the percentage based surcharge that is applied on exempt traffic. The carrier responded that they would be willing to apply the mileage based fuel surcharge; however, since they counted on the total revenues which included the higher percentage based fuel surcharge, the rates would need to be increased to make up the difference. We succeeded at negotiating an agreement favorable to the client, but this is only one example of the mindset we have encountered on numerous occasions, and an indication that fuel surcharge have developed into an integral part of rates and the railroads' revenue requirements.

Also, note Canadian National's comments in this proceeding supports that conclusion.[5]

4.0 THE SAFE HARBOR SHOULD BE MAINTAINED, AT LEAST FOR THE SHORT TERM.

In the initial decision, the Board responded to shipper arguments that use of a uniform fuel index would ensure accuracy, transparency, and accountability. While the Board did not mandate HDF the Board established a safe harbor for the railroads'

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[5] "In ordering rail carriers in 2007 to move away from percentage-of-rate-based surcharges to mileage-based surcharges.....the Board cleared the way for the use of surcharges as a reliable and efficient rate adjustment mechanism." Comments of Canadian National, STB Ex Parte No.. 661 (Sub No. 2, August 4, 2014, p. 3.

use of HDF to encourage the railroads to base their fuel surcharge mechanisms on HDF.[6]

The problem is not the Safe Harbor in itself; HDF does what it was designed to do – it tracks changes in diesel fuel costs. However, the railroads' fuel surcharge revenues have increased at a greater rate versus their fuel costs and the Safe Harbor relieves the railroads from responsibility to assess fuel surcharges programs for accuracy and fairness. With the current rules, all they are required to do is to apply the HDF Index and the fuel surcharge programs (which have developed into revenue enhancement programs) are protected by the current rules. Further, there is no penalty when a railroad's fuel surcharge program does not comply with the Board's directive to develop fuel surcharge programs that reflect actual fuel cost increases for related movements.

Still, if the Safe Harbor is eliminated, the railroads will no longer have an approved index on which to base their fuel surcharge programs and the result could be diminished transparency and credibility of the fuel surcharge programs.

We submit the Board should re-open *Fuel Surcharges* to conduct an in-depth review of the fuel surcharge programs. Issues to be addressed include, but are not limited to, whether or not the Board should redefine or modify the Safe Harbor to remove the immunity, or if it is simply time to terminate the fuel surcharge programs. However, while that review takes place, and until a go-forward strategy is developed, the Safe Harbor should be maintained to preclude potential chaos that could occur if the railroads adopted alternative indexes.

[6] STB Decision Document, EP_661_0, January 25, 2007, p. 9.

5.0 CONCLUSION AND REQUESTED ACTION

We appreciate the opportunity to participate in a discussion of fuel surcharges in the rail industry, and we commend the Board for initiating this proceeding. The fuel surcharge programs have been in effect for a lengthy period of time, fuel costs have been stable in recent years while the railroads have become more fuel efficient, so it is time to conduct a full review of the fuel surcharge programs to (a) confirm they are fair to all parties, ***or*** (b) identify changes that may be required ***or***, decide that the time has come to terminate the fuel surcharge programs.

We submit it is time for a review of the status of the fuel surcharge programs and we request that the Board re-open STB Ex Parte No. 661, *Rail Fuel Surcharges* for an in-depth review of the current rules for potential change, including potential removal of immunity and penalties to be assessed if the carriers over-recover with their fuel surcharge programs. Further, we submit the rules should also apply to shipments that are exempt from regulation.

More important, there are a number of reasons to question if there is a continuing need for the fuel surcharges. We submit the time has come to retire the fuel surcharge programs. Allied Shippers proposed phase-out of the fuel surcharge programs as an alternative to be explored.[7] Fuel costs have been stable in recent years with no *"unanticipated"* spikes in fuel costs; the railroads have become more fuel efficient; and since the current rules do not apply to exempt traffic (including traffic that moves on contract rates) the railroads already have the ability to increase

[7] 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 (collectively "Allied Shippers"), EP 661 (Sub-No, 2), dated August 4, 2013,

tariff rates for regulated shipments on statutory notice if they deem it necessary to cover future cost increases.

It is easy to understand why the railroads are protective of their fuel surcharge programs. 2013 fuel surcharge revenues reported by the four primary Class I railroads, BNSF, CSXT, NS, and UP totaled more than $7.9 billion. The railroads have created a monster with the fuel surcharge programs, but a key concern is their shareholders, so there is no graceful way for the railroads to exit the surcharge programs.

In the interim, while this review is taking place, the HDF Index should be maintained as a Safe Harbor. While the HDF Index, or any alternative index, may not accurately track changes in the railroads' fuel costs, it does what it was designed to do, i.e., to track changes in diesel fuel costs. The same situation would exist if alternative indexes were used and for now, the Safe Harbor serves a purpose by establishing transparency and credibility of the fuel surcharge programs.

In summary:

- We request that the Board re-open Ex Parte 661, Fuel Surcharges, for a full review of the surcharge programs and Fuel surcharge rules.
- Cargill was not an aberration; the railroads are over-recovering with their fuel surcharge programs. This should be investigated as a potential unreasonable practice.
- The Board should confirm the fuel surcharge programs are still relevant. If not, the fuel surcharge programs should be terminated.
- If a standard index, such as the HDF Index, is to be used, immunity should be removed. If the fuel surcharge programs continue, the rules should include a penalty if the fuel surcharge programs do not comply with the Board's directive and the railroad(s) over-recover.

- The Safe Harbor should be maintained at least for the short term, while the review is taking place to maintain transparency and credibility of the fuel surcharge programs.

- The fuel surcharge rules and decisions should apply to traffic exempt from regulation.

A full review of the fuel surcharge programs is warranted. It is not just a good thing to do – it is a matter of what is right and fair. Senator Burns said it best in his letter to former STB Chairman Buttrey, "It is the practice of charging *more* than the increase in fuel costs that truly amounts to an unreasonable practice. By charging more than the increase in fuel costs, The Class I railroads are simply adding to the bottom line and imposing new rate hikes on customers, not covering unexpected increases in operating expenses".[8] (Underscore for emphasis)

Respectfully submitted,

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[8] STB Ex Parte No.. 661, *Rail Fuel Surcharges,* Letter from U.S. Sen. Burns to STB Chairman Buttrey at 1 (filed May 8, 2006.