

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**RAIL FUEL SURCHARGES (SAFE HARBOR)**

236309

**STB Docket No. EP 661 (Sub-No. 2)**

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**INITIAL COMMENTS  
OF  
THE MERCURY GROUP  
A Shipper-Based Mobile Energy Study Group**

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**IDENTIFICATION OF THE MERCURY GROUP**

The Mercury Group is a shipper-based mobile energy study group focused on best practices and market innovations to reduce the energy consumption, energy costs and emissions associated with the movement of products to market. The Mercury Group was organized in 2008 and operates under the auspices of Breakthrough Fuel LLC (“Breakthrough”) and traditional shipper association antitrust compliance guidelines. The Mercury Group’s participants include market leading companies across the consumer goods industry, food industry, paper industry, retail, building products, manufacturing and machinery industries.<sup>1</sup>

Breakthrough works with shippers to understand, manage and reduce the amount and cost of energy used to move their products to market. This begins by providing market transparency throughout the shipper’s mobile energy life cycle, enabling an understanding of the unique energy consumption, energy cost and emissions associated with its product movements. With this understanding, Breakthrough and the shipper work to develop and execute strategies focused on reducing the amount and cost of energy consumed and the mobile emissions that occur

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<sup>1</sup> Public policy positions or statements of The Mercury Group are a product of a consensus process but, absent an express statement by the Participant, do not indicate or represent “endorsement” by any individual Participant of The Mercury Group.

in the movement of the shipper's products to market. Since 2005, Breakthrough has been an innovator in mobile energy life cycle management. Breakthrough has been awarded US Patents, No. 7,729,998 and No. 8,190,533 for its "*Method for Shippers to Manage Fuel Costs*" and its fuel innovative fuel management design. Since 2010, Breakthrough has offered a market-based fuel management program for rail intermodal shipments. Currently, Breakthrough manages in excess of 500,000 rail intermodal movements annually through these alternative market-based fuel programs.

#### **INITIAL COMMENTS – INTRODUCTION**

The management of fuel consumed by railroads in the movement of goods is emerging as one of the most important components of rail and rail intermodal competitiveness in the marketplace. If managed effectively, the inherent energy advantage of rail transportation becomes apparent and strengthens the competitiveness of freight rail transportation. If not managed well, rail competitiveness can be masked and transportation professionals making daily decisions on how to route freight are deprived of the information necessary to make optimal routing decisions. Moreover, if economic distortion is present in the financial transactions between shippers and railroads, then mistrust and conflict may well emerge between the parties. Such distrust and conflict may be created, not by the behavior of either party, but rather by unintended consequences of an artificial fuel surcharge program. The effects of

artificial fuel surcharges and the safe harbor provision are at the heart of the Board's request for comments.

Simply stated, fuel surcharge programs built on general indices or tables do not reflect the cost or consumption of the fuel used on any particular shipment and, thus, create economic distortion. When embedded into the marketplace, this economic distortion causes waste and inefficiencies that are entirely avoidable in today's marketplace, using available alternatives to traditional fuel surcharge programs. Furthermore, such waste and inefficiencies have the potential to impact not only the competitiveness of the railroads but, also, the competitiveness of the products that are moved by rail or would be moved by rail absent the economic distortion.

The Board specifically requests comment on whether the Department of Energy's "Energy Information Administration's On-Highway Retail Diesel Price Index" ("DOE Index") provides an accurate representation of the change in fuel costs from one period to another.

In short, the answer is: In a stable marketplace with consistent technology and predictable behavior, the DOE Index could be accurate. However, the energy marketplace is definitely not stable; technology is not consistent; and behavior cannot be predicted by the indexing methodology.

The energy marketplace is demonstrably both volatile and in transition. Technology to manage fuel consumption, alternative fuels and emissions are changing rapidly. The combination of these factors means

that the real marketplace for fuel in which the nation's freight transportation system operates is anything but stable; and, in turn, the safe harbor provision, relying on indexing methodology, is no longer an effective measure of the change in fuel prices.

### INITIAL COMMENTS

**A. The current safe harbor provision based on the DOE Index does not adequately account for changes in fuel market behavior and is not an effective proxy for railroad fuel costs.**

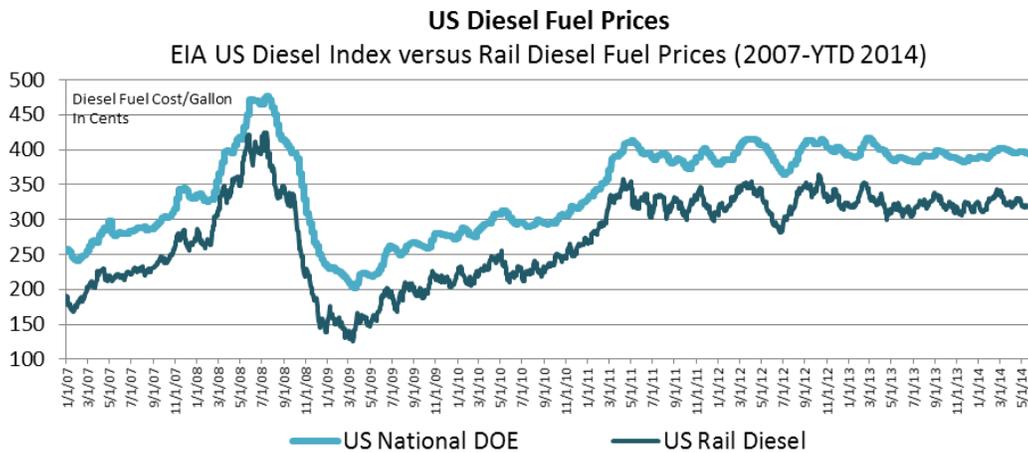
One could argue that, at the time of the original decision in STB EP 661 in January 2007, the DOE Index was a reasonable proxy for fuel prices. After all, the DOE Index was widely used in the trucking industry, and it was a marked improvement from other price alternatives such as West Texas Intermediate (WTI) crude oil. Further, the market had been relatively stable, and both shippers and the railroads had the ability to use historic metrics to anticipate the impact of movements in the energy markets. But much has changed since 2007.

We are now in a very different energy economy than existed in 2007. Since that time, the United States has seen an energy renaissance that has resulted in significant growth in production, changes in energy infrastructure, increased market volatility and significant shifts in fuel price behavior. An example of this can be seen in the dramatic growth in oil production in North Dakota. At the time of the 2007 decision, North Dakota has just completed a year (2006) in which crude production had averaged about 6,000 barrels-per-day. As of this date, production exceeds one million (1,000,000) barrels-per-day and is still growing. The ripple

effects of this new production have moved across much of the US economy and are changing fuel price behavior around the country.

It is instructive first to look closely at the behavior in both the DOE Index and market rail diesel fuel prices over this time period. If we look at Chart 1, “US Diesel Fuel Prices,” we can make a couple of initial observations:

### CHART 1



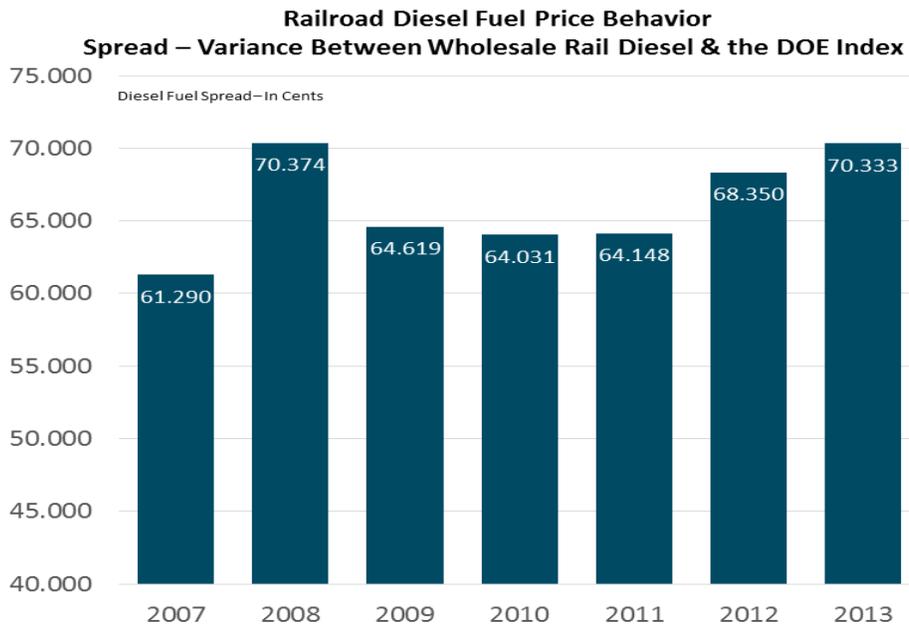
Source: US Department of Energy, Energy Information Administration; Breakthrough Fuel Proprietary Data

- First, it is fair to state that, on a macro-basis, the DOE Index and the market price for fuel that railroads are exposed to are related and show similar general behavior. However, we will show later in these Comments that the general observation can be seriously misleading.
- Second, if we look at the timeframe represented in Chart 1, January 2007 through May 2014, the average spread between the DOE Index and the market rail diesel price for fuel, we find the average spread (or variance between these two measures) is

66.2¢/gallon. The daily range, however, has varied between 28.8¢ on May 23, 2008 and \$1.295 on October 14, 2008. This extreme range highlights the potential distortion between the fuel marketplace for market rail diesel and the DOE Index.

Perhaps what is most relevant is the trends in the spreads that have occurred over this timeframe. If we look at Chart 2, the “Spread or Variance Between Wholesale Rail Diesel & the DOE Index,” we find that the average spread in 2007 was 61.29¢/gallon and that each subsequent year has exceeded the 2007 spread. In fact, this spread peaked in the most volatile year, 2008, at 70.374¢, slipped back to 64¢ for the years 2009, 2010 and 2011, and has now grown in the past two years to reach an average of 70.33¢/gallon in 2013.

**CHART 2**



Source: Breakthrough Fuel Proprietary Data

With an average spread in 2013 of 70.333¢/gallon – or a spread of 9.043¢/gallon greater than the base year of 2007 – we see the additional

premium provided by the DOE Index was over \$300 million across the rail industry. And, it should be noted that this DOE premium has no relationship to the cost railroads actually paid for fuel. Chart 3 shows that the DOE premium, by year, in the period between 2007 and 2013, provided increased economic distortion of more than \$1.2 billion.

**CHART 3**

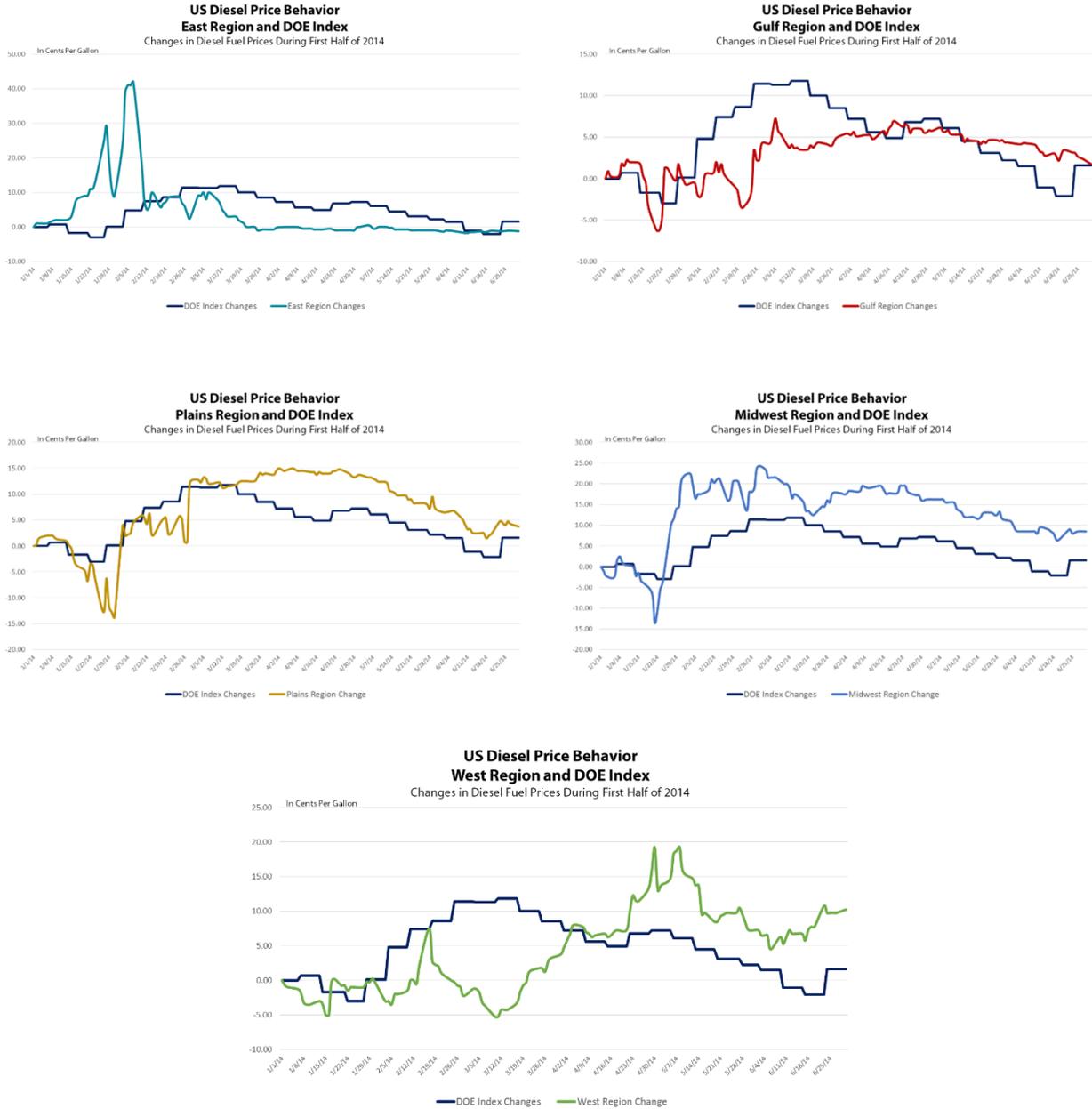
<b>RAIL DIESEL SPREAD BEHAVIOR</b>					
<b>WHOLESALE RAIL DIESEL VERSUS DOE INDEX</b>					
<b>2007 - 2013</b>					
	RAIL DIESEL GALLONS	Spread by	Base Spread	Spread	Financial Impact
YEAR	(In Millions)	Year (in cents)	(in cents)	Variance	
2007	4062	61.290	61.290	0.000	\$ -
2008	3886	70.374	61.290	9.084	\$ 353,004,240
2009	3192	64.619	61.290	3.329	\$ 106,261,680
2010	3494	64.031	61.290	2.741	\$ 95,770,540
2011	3685	64.148	61.290	2.858	\$ 105,317,300
2012	3634	68.350	61.290	7.060	\$ 256,560,400
2013	3322	70.333	61.290	9.043	\$ 300,408,460
				TOTAL	\$ 1,217,322,620

Sources Include: For Gallons, National Bureau of Transportation Statistics, Department of Energy and Surface Transportation Board Annual Reports. For Spreads, Breakthrough Fuel Proprietary Data

While the distortion created by the changing diesel fuel price behavior is significant, it is worth noting that the impact of this shift has not been evenly distributed. Rather, one of the significant changes in fuel behavior has been the shifts that are occurring in geographic behavior. As an example, the dramatic impact of the winter weather across the Northeast and Midwest early in 2014 provided diesel fuel price spikes in these regional areas. This impacted the cost of fuel for railroads operating in these regions but did not provide movement in the DOE Index to protect the railroads from the cost increase. Chart 4 highlights the regional impact on fuel prices over the first half of 2014 compared to the National DOE Index.

## CHART 4

### US Diesel 2014 Price Behavior by Region<sup>2</sup>



<sup>2</sup> The data above highlights the daily movement in fuel prices between the DOE Index (Source: Energy Information Administration) and the daily price movement in diesel fuel within the US diesel trading regions (Source: Bloomberg) with January 1, 2014 as a baseline.

**B. The current safe harbor provision 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.**

There are several emerging trends in energy and transportation whose potential impact should be considered in future rules and regulations. These trends include: (1) changes in on-highway fuel tax rates and policies; (2) potential regulations and market shifts relating to climate change and emissions; and (3) growth of alternative fuels in rail transportation. We will expand on each of these three topics to provide further context for our position that these changes will reduce the capability of the DOE Index to reflect market rail diesel costs.

**1. On-highway fuel tax rates and policies.**

There is growing debate in the political arena regarding methods to collect revenue to fund the nation's road infrastructure. We have recently seen several state's debate significant increases in diesel fuel road taxes to offset growing deficits in public funds for building and maintaining road infrastructure. A recent example of this is the 12.9¢/gallon increase in diesel fuel tax in the State of Pennsylvania that was effective on January 1, 2014. This type of tax increase, and the expectation that tax changes take place in other jurisdictions, will further distort the relationship between the DOE Index and market rail diesel.

There has also been growing debate at the federal level about changes in road fuel taxes. There have been two very different methodologies discussed at the federal level that could potentially create significant changes in the behavior of the DOE Index without impacting

market rail diesel costs. The first example of this is the potential of a distance or mileage-based user fee to replace the current method of a per-gallon fuel tax. Such a user fee method was recommended by the National Surface Transportation Infrastructure Financing Commission in its 2009 report, *“Paying Our Way: A New Framework for Transportation Financing.”* A second example is the bi-partisan proposal by Senator Murphy (D-CT) and Senator Corker (R-TN) to increase the federal diesel fuel tax by 12.0¢/gallon to 36.4¢/gallon from the current 24.4¢ that was announced just last month.

Again, these potential changes in both on-road diesel fuel tax rate and method changes would significantly alter the behavior of the DOE Index without having a corresponding impact on the market rail diesel costs incurred by the railroads.

## **2. Potential climate change and changes in emissions regulations.**

We anticipate a growing public debate on climate change and emissions rules that may impact the cost of transportation fuels and, with the inherent differences in fuel efficiency between truck and rail transportation modes, will impact these modes differently. This variance will create further distortion in fuel price behavior between the DOE Index and market rail diesel. An example of this is the Low-Carbon Fuel Standard (LCFS) being implemented in California and under consideration in other jurisdictions as well.

An additional consideration is that more shippers are voluntarily reporting their transportation emissions and creating targets for emissions

reductions. The current artificial fuel surcharge methods do not provide the transparency necessary to accurately track transportation emissions and the carbon intensities of different transportation modes. Again, while the increased fuel efficiency of rail transportation is widely understood, its benefits are not easily visible for the purposes of managing carbon emissions created by shipping products.

### **3. Growth of alternative fuels in rail transportation.**

The rail industry is currently experimenting with several alternative fuels that may emerge as meaningful methods of powering locomotives in the future. And, at the very least, they have the potential to become niche fuels that may impact the overall fuel-related costs incurred by railroads that will not be reflected in the current safe harbor provision relying on the DOE Index which only anticipates diesel fuel. Examples of these experiments include:

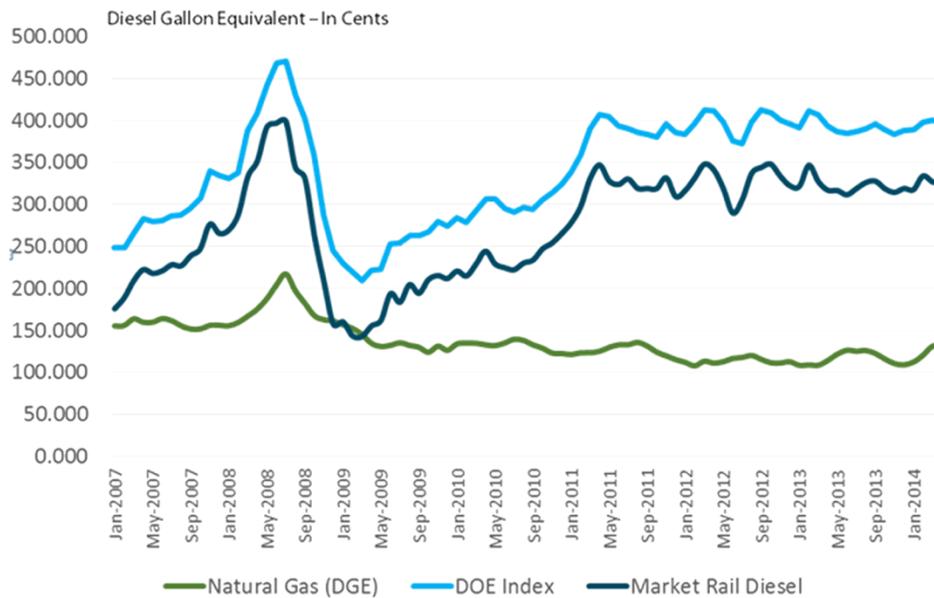
- The BNSF has announced that they are experimenting with liquefied natural gas (LNG) powered vehicles in switch locomotives and intermodal applications. They have also announced an experimental hydrogen fuel cell locomotive in conjunction with a Department of Defense program.
- The Union Pacific has announced that they are experimenting with LNG-powered locomotives as well as hybrid electric-powered vehicles.
- Norfolk Southern has announced that they are “exploring a wide range of alternative fuels, from soybean-based biodiesel

and electric engines to hydrogen fuel cells and high-powered engines fueled by ethanol,” in their *2013 Sustainability Report*.

- CSX Corporation has announced they will partner with GE Transportation in a pilot study using LNG to power their Evolution Series locomotives.

These examples indicate the growing interest in alternative fuels within the rail industry and suggest that future fuel management programs should enable the visibility of alternative fuel programs within the commercial relationship between railroad shippers and the railroads themselves.

**CHART 5**  
**Transportation Fuel Price Behavior**  
**Natural Gas, DOE Index & Market Rail Diesel**  
**January 2007 – April 2014 (By Month)**



Source: DOE Energy Information Agency & Breakthrough Fuel Proprietary Data

And, as Chart 5 shows, when one looks at natural gas prices, adjusted to be represented in diesel gallon equivalents (as defined by

384,700 btu per diesel gallon), then the DOE Index becomes even less relevant to transportation fuel prices.

In summary, it is likely that public policy changes and emerging technologies enabling alternative fuels will impact the cost of fuel used by the railroads. The current safe harbor provision relying on the DOE Index cannot account for these emerging trends. These trends should be a consideration for future rulemaking such as modification of the safe harbor provision.

**C. Fuel efficiency is a critical component of rail fuel management and an essential element in judging the reasonableness of fuel surcharge programs.**

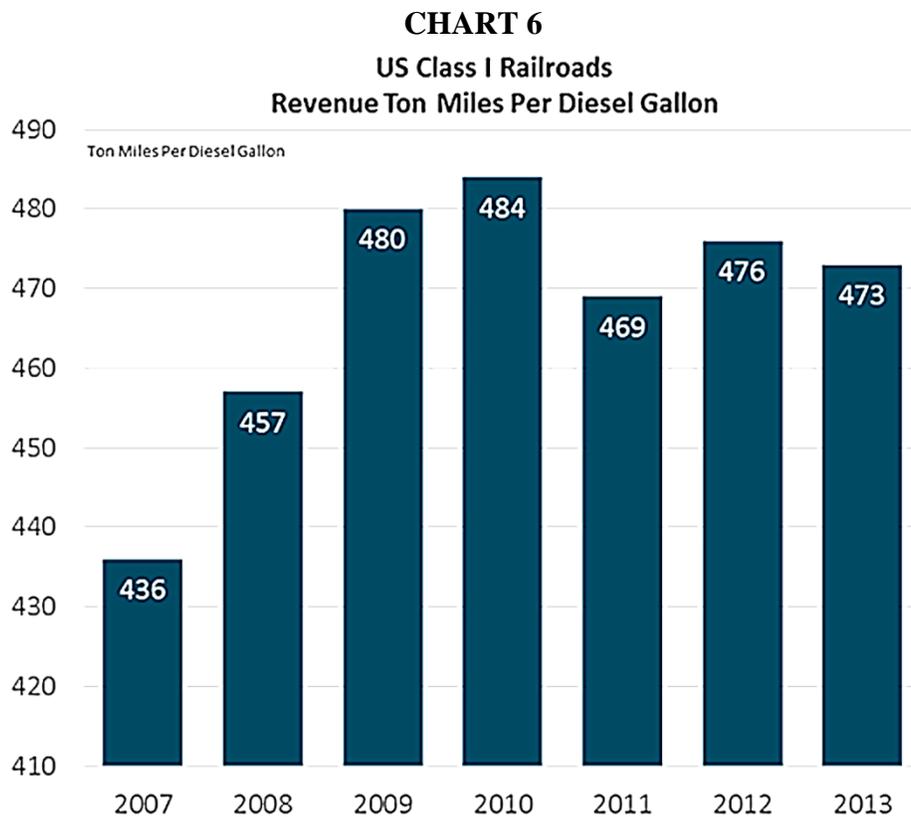
One of the important considerations in any fuel management program, including in the economic relationship between railroad and shipper, is the fuel efficiency of the transportation.

There are several reasons why fuel efficiency should be incorporated into future rules:

- Any accurate representation of fuel costs requires an understanding of and visibility to fuel efficiency;
- Visibility of fuel efficiency is necessary for transportation planners to make accurate daily decisions about mode and carrier selection;
- Visibility of fuel efficiency is important for logistics analysts to model routing guides and optimize transportation plans; and
- Fuel efficiency is critical to understand the emissions associated with transportation movements and to accurately

report the carbon intensity of supply chains.

Perhaps most critical is the impact that fuel efficiency has on rail competitiveness and rail economics. Chart 6 highlights the fuel efficiency of the rail industry, as reported by the industry in their revenue ton-miles per diesel gallon metric. As the chart highlights, the base year of 2007 or year of the prior STB ruling saw the industry moving 436 ton miles of freight on a single gallon of diesel fuel.



Source: Association of American Railroads

As Chart 6 highlights, fuel efficiency peaked at 484 ton-miles per gallon in 2009 and ended the most recent year, 2013, at 473. Perhaps what is most meaningful is that, as Chart 7 shows, this improvement in fuel efficiency may have saved as much as 2 billion gallons of diesel over six year period (2008-2013) when using 2007 as a base year. In addition, this

improvement in fuel efficiency avoided over 21 million metric tons of carbon being emitted by rail transportation.

### CHART 7

RAIL DIESEL FUEL EFFICIENCY					
REVENUE TON MILES PER DIESEL GALLON					
2007 - 2013					
YEAR	RAIL DIESEL GALLONS (In Millions)	Fuel Efficiency Ton Miles/Gallon	Fuel Efficiency Improvement from Base Year	Gallons Avoided Through Fuel Efficiency	CO2 Emissions Avoided (in Metric Tons)
2007	4062	436	na	0	0
2008	3886	457	4.82%	195,646,789	2,033,357
2009	3192	480	10.09%	409,926,606	4,260,367
2010	3494	484	11.01%	447,192,661	4,647,673
2011	3685	469	7.57%	307,444,954	3,195,275
2012	3634	476	9.17%	372,660,550	3,873,061
2013	3322	473	7.82%	317,746,300	3,302,337
TOTALS				2,050,617,860	21,312,071

Sources: For Fuel Efficiency: Breakthrough Fuel Proprietary Data

In summary, rail transportation should be advantaged in the marketplace based on its inherent energy efficiency; and, yet, traditional fuel surcharge programs can mask this benefit. Further, improvements in fuel efficiency have the potential of enhancing both the competitiveness of rail transportation and the competitiveness of the products being shipped via the railroads. As a result, we believe it is in the best interest of both parties – railroads and shippers – and, of course, the public, to have the same visibility into fuel efficiency and have it incorporated into the economic agreement between the parties.

**D. Lack of fuel program transparency creates distrust and encourages conflict and litigation.**

Traditional fuel surcharge programs have been an on-going source of mistrust and conflict between the railroads and the rail shippers. This is evident not only in the dispute that facilitated the Board’s request for

comments but is, also, evident in the on-going fuel surcharge antitrust litigation tediously advancing through the federal court system.

The pending litigation exposes specific named railroads to significant expenses and potential penalties as a result of the lack of transparency provided by their existing programs. The impact of this litigation extends beyond its financial implications. It is our experience – and we have been told directly by key people within the rail industry – that the industry is reluctant to engage in discussions on alternative fuel management programs specifically because of the pending antitrust litigation.

Thus, we believe that modification of the current safe harbor provision should encourage and not discourage the exploration of alternative, market-based rail fuel programs to advance the competitiveness of the marketplace.

**E. Marketplace alternatives to the fuel surcharge provide real transparency and directly measure changes in fuel costs.**

Fortunately, the marketplace currently has alternatives to fuel surcharges that provide fuel information transparency and enable the important economic advantages discussed above.

As an example, Breakthrough's Intermodal Fuel Recovery Program enables accurate fuel information to be provided on individual intermodal freight movements. It accomplishes this by:

- Breaking the intermodal movement into its unique segments: truck drayage and rail movement;

- Determining the fuel economics on each of the individual truck movements including the distance (miles), fuel economy (mpg), market fuel costs unique to the movement and actual fuel taxes required by the movement, calculated and updated daily; and
- Determining the fuel economics on the individual rail segment including the distance (rail miles), rail fuel economy (ton miles), market fuel costs unique to the movement and actual rail fuel taxes required by the movement, calculated and updated daily.<sup>3</sup>

As a result, the Breakthrough process provides information – to all parties, the shipper and the transportation carriers – such as:

- The fuel consumed by the individual freight movement;
- The fuel costs directly associated with the freight movement; and
- The carbon emissions created by the freight movement.

This information is currently used:

- By shippers and carriers to understand the actual fuel costs associated with each unique freight movement;
- By shippers to reimburse transportation providers for the fuel costs incurred on the individual movements;
- By carriers to use in bidding and pricing line-haul rates;
- By shippers to assess competitive carrier bids and competitive

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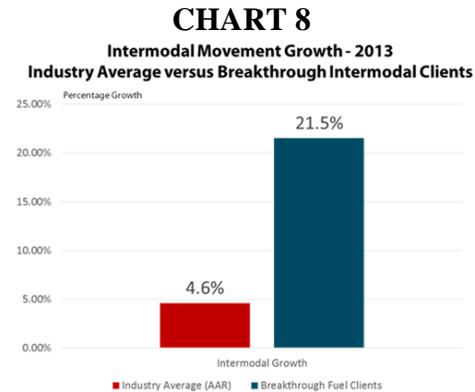
<sup>3</sup> The same process would permit one of two railroads in a joint line movement to retain the fuel surcharge methodology while the other railroad employs a market-based fuel program.

mode alternatives – allowing for a true comparison of total costs (line-haul and fuel), in many cases, for the first time;

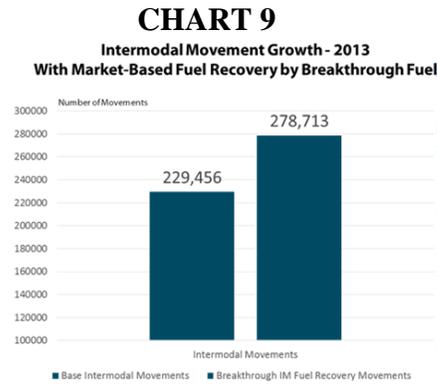
- By shippers to assess competitive facility alternatives – such as distribution center locations – on a total cost basis;
- By shippers to understand their fuel market risk and design fuel risk programs based on actual gallon consumption and market exposures, in many cases, for the first time;
- By shippers to calculate their carbon footprint – and understand emissions, in many cases, for the first time; and
- By shippers and carriers to assess the economic and environmental impacts of alternative and renewable fuels – and to advance those impacts to the broader marketplace.

The capability to provide fuel information transparency – and the above uses – exists today. Breakthrough currently processes over 7.2 million unique freight movements, including truckload and intermodal movements, annually from across North America. It is also worth noting that when transparency exists and fuel management is a visible part of the routing decision, then conversion from truckload to intermodal takes place at a much greater rate than it would otherwise. This is evident when one compares industry data, from the Association of American Railroads, that shows that intermodal growth in 2013 was 4.6% across the industry, to shippers utilizing the Breakthrough process who experienced 21.5% growth in their intermodal movements (see Chart 8). The actual intermodal movement growth with Breakthrough’s clients can be seen in

Chart 9. It should be noted that the movement growth includes clients with two-full years of fuel management and does not include new clients. As previously referenced, the total number of intermodal movements managed by Breakthrough exceeds 500,000 annually.<sup>4</sup>



Source: Association of American Railroads  
 Breakthrough Fuel Proprietary Data



Source: Breakthrough Fuel Proprietary Data

Note: Intermodal Movement growth is based on existing client intermodal growth and does not include new client or movement additions during the year.

## CONCLUSION AND REQUESTED ACTION

We appreciate the opportunity presented by the Surface Transportation Board to provide comments on the general area of fuel surcharges and fuel management programs in the rail industry. We believe recent shifts in the marketplace and the advancement of technology makes it timely to do so.

We also believe that the industry, in absence of action by this Board and under the threat of pending antitrust litigation, is unlikely to pursue changes to current industry practices and advance the practice of fuel management as quickly as other modes of transportation. Specifically, over-

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<sup>4</sup> Transaction expense paid to Breakthrough is borne by the shipper not the railroad or other carrier.

the-road and marine fuel are rapidly adapting to the new market realities. Further, without making substantive changes, the rail industry risks losing ground to truck and water borne transportation unnecessarily – where, with marketplace transparency for fuel costs, rail or rail intermodal would be chosen as the more efficient, competitive mode.

At the same time, we believe it is important to avoid disruption in the marketplace and to avoid the chaos that could be presented with radical and immediate, mandated change. As a result, we believe a staged and controlled movement to a market-responsive fuel management method is worth consideration and is an approach that we would recommend.

The Mercury Group submits that a limited, balanced and potentially temporary regulatory intervention is needed to overcome inertia and apparent chilling effects on exploration of alternatives to indexed fuel surcharges, likely, in part, an unintended consequence of private antitrust litigation involving rail carrier fuel surcharges which have been exempted from regulation. The Mercury Group recommends the Board consider the following:

**A. Extend the scope of the safe harbor provision.**

As to rates and charges intended to recover the cost of fuel consumed in the transportation, 49 USC § 10102(9), of property, temporarily, revoke all exemptions from the Board’s reasonable practice jurisdiction.

We believe eliminating the exemptions, for fuel-related matters only, is consistent with the policy advanced in the Board’s prior ruling,

will enhance the competitiveness of captive and non-captive rail freight, and will minimize impediments to marketplace solutions to fuel management resulting from pending antitrust litigation and threats of potential future litigation.

**B. Modify the safe harbor provision.**

We are concerned that an immediate elimination of the safe harbor provision may encourage conflict and further litigation. Rather, we recommend modifying the safe harbor rule in a staged manner:

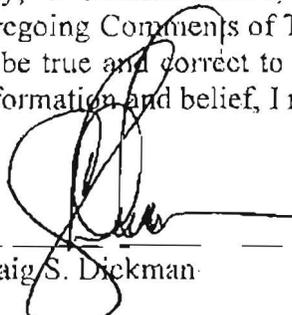
- Maintain the DOE Index as a reasonable method for determining changes in fuel price for a set period, with the safe harbor provision to be phased out within five years or whatever period the Board determines appropriate.
- Incorporate fuel efficiency requirements, to be updated annually, into the fuel surcharge tables that would fall under the safe harbor provision. With the revocation of the exemptions, discussed above, for fuel-related matters only, the industry would necessarily shift to distance-based fuel surcharge designs. These new programs could readily incorporate fuel efficiency into the design much as the over-the-road truck segment does today. We encourage the Board to include fuel efficiency in the safe harbor provision within the next two years.
- During the proposed safe harbor period, encourage the rail industry to investigate, and monitor the rail industry's progress

in moving to, market-based fuel programs which accurately represent the fuel efficiency and fuel costs of individual freight movements. Further, we would recommend extending the safe harbor provision to mutual shipper-railroad market-fuel management pilot programs to prepare for the emerging market when the safe harbor provision and temporary revocation of exemptions as to fuel, can be removed completely, replaced by accurate and transparent fuel programs, for all rail movements and shippers, developed in the marketplace.

Respectfully submitted this 11<sup>th</sup> day of July, 2014.

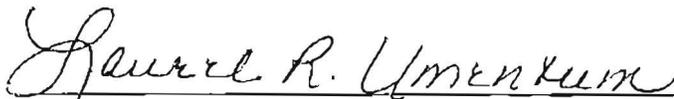
**Verification**

I, Craig S. Dickman, the Chief Executive Officer of Breakthrough Fuel, LLC, whose principal place of business, 400 S. Washington Street, Green Bay, Wisconsin 54301, hereby affirm and verify that I have read the foregoing Comments of The Mercury Group, know the facts stated therein to be true and correct to my own knowledge and, as to those stated upon information and belief, I reasonably believe them to be true and correct.

  
\_\_\_\_\_  
Craig S. Dickman

STATE OF WISCONSIN    )  
  ) ss  
BROWN COUNTY         )

Personally came before me this 11<sup>th</sup> day of July, 2014, the above named Craig S. Dickman, personally known to me to be the person who executed the foregoing verification and acknowledged the same.

  
\_\_\_\_\_  
Notary Public, State of Wisconsin

**LAUREL R. UMENTUM**  
Notary Public  
State of Wisconsin

My commission . 8/2/15

