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Cynthia T. Brown
Chief of the Section of Administration, Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington, DC 20423

Re: **Rail Fuel Surcharges (Safe Harbor), STB Ex Parte No. 661 (Sub-No. 2)**

Dear Ms. Brown:

Enclosed are BNSF Railway Company's Opening Comments for filing in the above-captioned matter. Please note that the filing contains color images.

Thank you for your assistance.

Sincerely,

Anthony LaRocca (KG)

Anthony J. LaRocca
Counsel for BNSF Railway Company

Enclosure

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL FUEL SURCHARGES (SAFE HARBOR)

BNSF RAILWAY COMPANY'S OPENING COMMENTS

BNSF Railway Company ("BNSF") hereby submits its opening comments in response to the Board's request in *Rail Fuel Surcharges (Safe Harbor),* Ex Parte No. 661 (Sub-No. 2) (STB served May 29, 2014) ("*Safe Harbor*") for comments on the safe harbor provision established in *Rail Fuel Surcharges*, Ex Parte No. 661 (STB served Jan. 26, 2007) ("*Fuel Surcharges*"). For the reasons explained below, BNSF believes that the safe harbor established in *Fuel Surcharges* provides important benefits to railroads and shippers and it should be retained without modification.

I. INTRODUCTION

In *Fuel Surcharges*, the Board adopted a safe harbor for the use of the Highway Diesel Fuel ("HDF") index issued by the U.S. Energy Information Administration in railroad fuel surcharges after concluding, among other things, that the HDF index reasonably tracks changes in railroads' fuel costs. The Board initiated this proceeding to determine whether that conclusion remains valid. As explained below, with the exception of a few years before 2011 when fuel prices were highly unstable, the HDF index has closely tracked changes in BNSF's internal fuel price. Since 2011, there has been virtually no divergence on average between changes in the HDF index and BNSF's annual internal fuel price. The HDF index remains a valid basis for the calculation of fuel surcharges.

The Board's adoption of a safe harbor for the use of the HDF index was based on a recognition of the substantial benefits to rail shippers that flow from the use of a government-issued public index, like the HDF index, to track changes in fuel cost. The Board accepted shippers' view that the use of a public fuel price index that reasonably tracks railroad fuel costs would be preferable to basing fuel surcharges on non-public and firm-specific data on railroads' internal price of fuel. The use of the HDF index to track fuel costs would ensure the transparency and accountability of fuel surcharge calculations, making fuel surcharges simpler and more credible. *Fuel Surcharges* at 11. A safe harbor for the use of the HDF index would encourage railroads to use it in their fuel surcharges. The benefits from the use of the HDF index have not diminished since the Board's *Fuel Surcharges* decision.

The fact that the HDF index did not perfectly track BNSF's internal fuel price during the latter half of the 2000s, the period of time covered by the Board's analysis in *Cargill, Inc. v. BNSF Railway Co.*, NOR Docket No. 42120 (STB served Aug. 12, 2013) ("*Cargill*"), does not justify removing the safe harbor. The Board has never expected or required fuel surcharges to recover a railroad's fuel costs with absolute precision. When the Board initiated the present proceeding, it 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. But that divergence was modest in percentage terms and occurred over a limited period of time. Moreover, the Board's analysis of fuel cost recovery in *Cargill* did not consider the substantial costs incurred by BNSF in its various fuel-efficiency initiatives, including the purchase of fuel-efficient locomotives. Most important, even the modest divergence between BNSF's fuel surcharge revenues and its incremental fuel costs in the Board's *Cargill* analysis for the years 2006-2010 is no longer a concern since the HDF index and

BNSF's internal fuel prices have moved even more closely in tandem since 2010. The divergence between the HDF index values and BNSF's internal fuel price over the *Cargill* analysis period appears to have been the product of circumstances during that time period.

In short, BNSF and its shippers value a simple, stable and readily administrable fuel surcharge mechanism. Many shippers move traffic from a large number of origins to a large number of destinations, and they strongly prefer a transparent and credible fuel surcharge mechanism to simplify their accounting processes. The consequence of eliminating the safe harbor may be to push railroads to consider eliminating fuel surcharges or use their internal fuel price data as the basis for calculating fuel surcharges instead of the HDF index, thus eliminating the transparency that shippers have strongly desired and leading to more uncertainty regarding railroads' fuel cost recovery mechanisms. The Board should not unnecessarily discourage or eliminate the use of an open and transparent HDF mechanism for tracking changes in fuel cost out of 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. The Board should retain the HDF safe harbor.

II. ARGUMENT

A. The Board Adopted The HDF Safe Harbor In 2007 In Recognition Of The Substantial Benefits To Rail Shippers From The Use Of A Public Index.

On May 11, 2006, the Board held a hearing to address growing concerns by rail shippers over railroad fuel surcharge practices. The principal focus of the shipper concerns was the use by railroads of percentage-based fuel surcharges that linked the amount of the fuel surcharge to the level of the rate charged on a particular shipment rather than to the transportation characteristics of the movement. Following the hearing, the Board sought comments on a proposal to require that railroads' fuel surcharges on regulated traffic bear a "reasonable nexus" to fuel consumption and on other measures that would make railroad fuel surcharge practices more transparent. *Rail Fuel Surcharges*, STB Ex Parte No. 661, at 5 (STB served Aug. 3, 2006) ("*2006 Surcharge Proposal*").

Among other proposed measures, the Board proposed to mandate the use of the HDF index as the basis for tracking changes in fuel price in fuel surcharge mechanisms. *Id*. at 6. The Board observed that the HDF Index "closely correlates with other fuel cost indices, including the indices currently used by most carriers" and "has a .997 correlation with the EIA Refiner Prices of Petroleum Products to End Users and a .998 correlation with the Association of American Railroad's fuel cost index." *Id*. The Board noted that the HDF index is published by a neutral and respected entity, the "independent statistical arm of the Department of Energy, created by Congress for the express purpose of providing policy-neutral data and forecasts." *Id*. The HDF index also had a minimal lag of one month (*i.e.*, the index tracked fuel costs from one month earlier) while "other indices can lag 2 or 3 months behind the cost increases they measure." *Id*.

The shippers that commented on the Board's proposals generally supported use of the HDF index in rail fuel surcharges. *See, e.g.,* American Chemistry Council, Snavely King Comments, at 5 (filed Oct. 2, 2006) (stating that the HDF Index "has merit … [a]s an index for measuring changes in fuel prices that the Class I railroads may experience"); The Fertilizer Institute Comments, at 3 (Oct. 2, 2006) ("TFI has no objection to the Board's choice" of the HDF Index); The National Industrial Transportation League Comments, at 9 (filed Oct. 2, 2006) (the HDF Index is "generally acceptable"). The shippers recognized several benefits that would flow from railroads' use of the HDF index.

The key benefit from the use of the HDF index was transparency, which the Board concluded "enhance[s] the credibility of fuel surcharges in the eyes of those who pay them." *Fuel Surcharges* at 11. A major concern expressed to the Board in the 2006 hearing on fuel surcharges was that shippers had difficulty understanding how the fuel surcharges were calculated by different railroads, making it difficult for shippers to assess the reasonableness of the charge. The Department of Transportation noted that if "the index relied upon is publicly available and clear, all parties are in a position to assess the reasonableness of any fuel surcharges that result." DOT Comments, at 3 (filed Oct. 2, 2006). Several shippers noted their strong interest in the use of a transparent fuel price index. *See, e.g.*, Edison Electric Institute Comments, at 2 (filed Oct. 2, 2006) (stating that the HDF Index will "provide a basis for fair and transparent calculations"); American Chemistry Council Comments, at 3 (filed Oct. 2, 2006) ("ACC understands the use of the Energy Information Administration's 'U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon)' due to its transparency and wide availability.").

Use of a fuel price index published by a neutral and accountable third party also made fuel surcharges more credible by dispelling suspicion about the calculations of fuel price changes underlying the surcharge. As noted by the Edison Electric Institute, EIA's data is "widely respected throughout the energy industry." Edison Electric Institute Comments, at 2 (filed Oct. 2, 2006); *see also* Steel Manufacturers Association Comments, at 2-3 (filed Sept. 26, 2006) ("The data provided in this Department of Energy-sponsored index is policy-neutral…."); Concerned Captive Coal Shippers Comments, Heller Supplemental Statement, at 2 (filed Oct. 2, 2006) (the HDF Index "is compiled independently which may make it preferable to rail customers" as compared to price indices created by railroads or their representatives).

A number of commenters noted the superiority of the HDF index over other possible mechanisms to measure fuel price changes. Several shippers observed that the HDF index is highly correlated to changes in railroads' fuel prices. *See, e.g.*, Total Petrochemicals Comments, at 3 (filed Oct. 2, 2006) (the HDF Index's "correlation with the AAR fuel cost index is, as the Board noted, quite high (0.998)"); *Fuel Surcharges* at 11 (finding there was "general agreement" among shipper commenters that the HDF Index "accurately reflects changes in fuel costs in the rail industry"). Shippers noted that the HDF index was also highly responsive to changes in fuel price and incorporated only a one-month lag between the index value and the fuel prices on which the index value was determined. *See, e.g.*, Steel Manufacturers Association Comments, at 2-3 (filed Sept. 26, 2006) (the HDF Index "is available with only a one-month lag"). Further, a number of shippers noted that alternative public indices, like the West Texas Intermediate ("WTI") Crude index, were inferior mechanisms for tracking changes in railroads' fuel prices. *See, e.g.*, Alliance of Automobile Manufacturers Comments, at 3 (filed Apr. 7, 2006) ("The railroads do not use WTI Crude to power their locomotives, so changes in the cost of WTI bear no direct relation to changes in the cost of the fuel the railroads are using"); American Chemistry Council Comments, at 3 (filed Oct. 2, 2006) ("Crude oil prices (West Texas Intermediate) are inappropriate.").

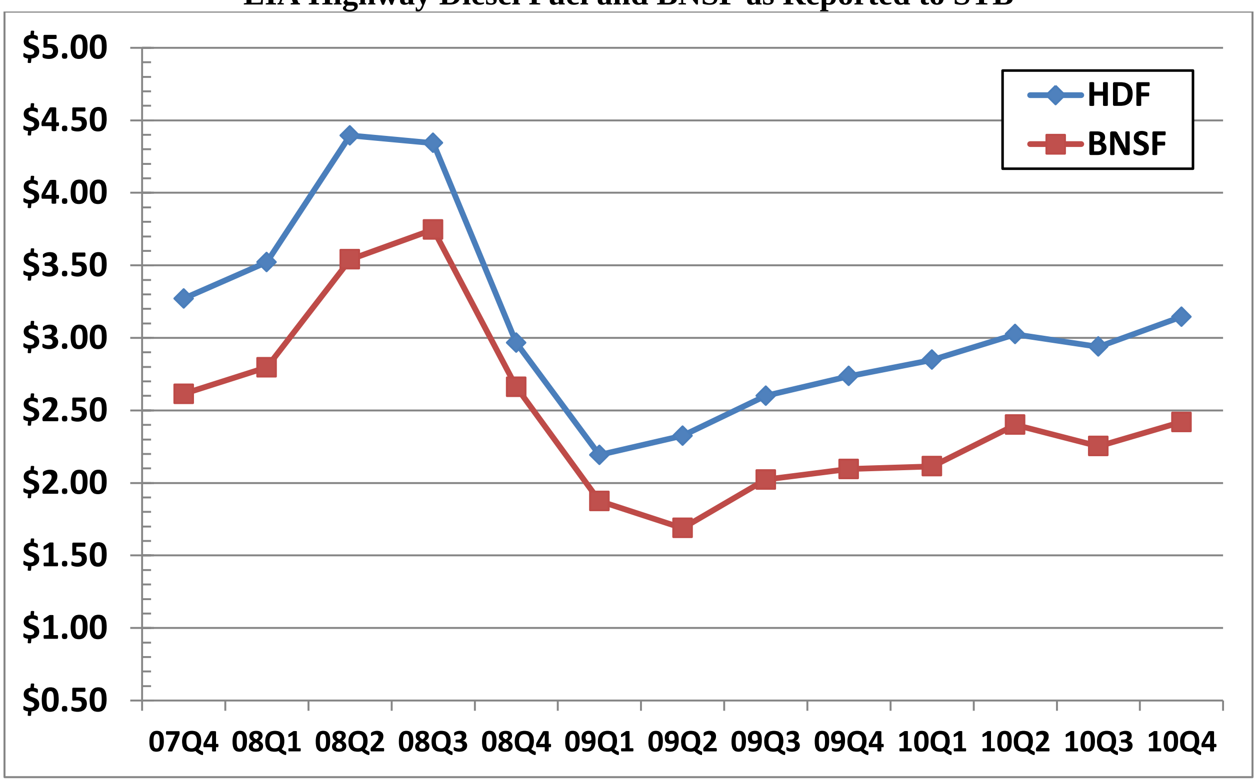
After reviewing comments on the proposal to mandate use of the HDF index, the Board concluded that "[s]trong support has been expressed in the record for the proposal that railroads apply a single, uniform index to measure changes in fuel prices." *Fuel Surcharges* at 11. The Board further concluded that there was "general agreement" that the HDF Index "accurately reflects changes in fuel costs in the rail industry" and that "it is a reasonable index to apply to measure changes in fuel costs for purposes of a fuel surcharge program." *Id*. The Board chose not to mandate the use of the HDF index so as not to "hinder the Board's ability to respond nimbly should a superior index be identified." *Id.* Instead, the Board established a safe harbor for railroads' use of the HDF index to encourage railroads to base their fuel surcharge mechanisms on the publicly available and readily monitored HDF index. If railroads chose an alternative index, the Board noted that the fuel surcharge mechanism would be subject to challenge based on the reasonableness of the index used. *Id.*

B. The Board Should Continue To Encourage The Use Of The HDF Index In Railroad Fuel Surcharges By Maintaining The Safe Harbor.

There is no reason to believe that the benefits from the use of the HDF index in railroad fuel surcharges in terms of transparency, simplicity and ease of administration, have changed or diminished at all since the *Fuel Surcharges* decision. The Board initiated this proceeding to determine whether the Board's assumption that the HDF index reasonably tracks railroad prices remains valid in light of its finding in *Cargill* that there was a divergence between the HDF index and BNSF's internal fuel price over the period 2006-2010. In *Cargill*, the Board found that over the five-year analysis period, there was an increasing "spread" between BNSF's internal fuel price and the HDF, with the HDF fuel price increasing somewhat more over this time period than BNSF's internal fuel price.

The potential for a divergence between fuel surcharge revenue and incremental costs – whether increasing or contracting – is undeniable in a fuel surcharge that uses the HDF index. But the Board has recognized that it is unrealistic to expect any fuel surcharge mechanism to precisely track fuel costs. The Board has never required a precise match between fuel surcharge revenue and fuel consumption or fuel cost. In *Fuel Surcharges*, the Board recognized that railroads need to strike a balance between precision on the one hand and transparency, simplicity and ease of administration of the surcharge mechanism on the other hand. The Board's *Cargill* decision emphasized that fuel surcharges must only bear a "reasonable nexus" to fuel consumption. *Cargill* at 17; *see also Dairyland Power Coop. v. Union Pac. R.R. Co.*, STB Docket No. 42105, at 6 (STB served July 29, 2008). Since a precise fit is unrealistic, the question should be whether the fuel index used in the surcharge *reasonably* tracks the railroad's actual fuel price. And as shown in Figure 1 below, over the period 4th Quarter 2007 through 2010, the time period within the *Cargill* analysis period for which there are public data from the Board on BNSF's internal fuel prices, the HDF index closely tracked BNSF's internal fuel price.

Figure 1
Quarterly Fuel Costs per Gallon, 2007-2010:
EIA Highway Diesel Fuel and BNSF as Reported to STB



Sources:
http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=EMD_EPD2D_PTE_NUS_DPG&f=M
http://www.stb.dot.gov/econdata.nsf/260029d11703bd498525740100662c49?OpenView&Start=1&Count=300&Collapse=1#1

While Figure 1 above shows that there was a close correlation between the HDF price and BNSF's internal fuel price, there was some divergence over the *Cargill* analysis period between the HDF and BNSF's internal fuel price. The Board found that the divergence between the HDF index and BNSF's internal fuel price resulted in a difference between fuel surcharge revenues over the five-year period and internal fuel costs of $181 million. The Board's calculation did not consider other fuel-related costs BNSF incurred during the same time period, such as investment costs for fuel efficient locomotives. Nevertheless, the Board noted that it was concerned about the size of the disparity between revenues and apparent internal costs.

However, the divergence between revenues and costs over the time period covered by the *Cargill* analysis appears to have resulted in large part from the unprecedented volatility in fuel price during that time period.[1] In fact, over the period from 2006 through 2010, the spread between BNSF's internal fuel price and the HDF index increased, as the Board observed. But in 2011, BNSF modified its mileage-based fuel surcharge ("MBFSC") by resetting the fuel surcharge strike price – *i.e.*, the starting point for calculating the fuel surcharge – so that the fuel surcharge would be a much smaller portion of a shipper's all-in transportation price.[2] And from the time of that rebasing through 2013, the "spread" between the HDF and BNSF's publicly reported fuel price has stabilized. As illustrated in Figure 2 below, the "spread" continues to change from quarter to quarter, but on an annual average basis it has remained virtually

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[1] The Board recognized in its initiation of this proceeding that the extremely volatile fuel prices in the latter half of the decade may have contributed to the divergence between revenues and costs in that case. *See Safe Harbor* at 3, seeking comments on whether the "phenomenon that we observed in *Cargill* (a growing 'spread' between a rail carrier's internal fuel costs and the HDF Index) was likely an aberration."

[2] *See* BNSF Railway Company's October 24, 2011 Reply Evidence and Argument at 45-47; Verified Statement of Paul B. Anderson at 32-35.

unchanged over the period 2011-2013. The average spread between BNSF's internal fuel price and the HDF for the year 2011 was $0.74; the average spread for the year 2012 was $0.74; and the average spread for 2013 increased by only one cent to $0.75.

Figure 2
Quarterly Fuel Costs per Gallon, 2011-2013:
EIA Highway Diesel Fuel and BNSF as Reported to STB

Spread	$0.87	$0.74	$0.65	$0.73	$0.81	$0.65	$0.78	$0.70	$0.79	$0.74	$0.71	$0.77
Annual Average	**$0.74**				**$0.74**				**$0.75**			

Sources:
http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=EMD_EPD2D_PTE_NUS_DPG&f=M
http://www.stb.dot.gov/econdata.nsf/260029d11703bd498525740100662c49?OpenView&Start=1&Count=300&Collapse=1#1

The Board initiated this proceeding out of a concern that the "changes in the HDF index did not precisely reflect changes in BNSF's internal fuel costs." *Safe Harbor* at 2. But over the last three years, there has been virtually no divergence on an average annual basis between the HDF index and BNSF's internal fuel prices. In short, the concerns leading to the initiation of this proceeding appear to be the result of historical factors that have not existed in the past three and a half years.

The Board should also be comfortable with the magnitude of the divergence between revenues and costs in the *Cargill* calculations in light of the Board's "reasonable nexus" standard, which does not require absolute precision. The *Cargill* case focused on a five-year period that was characterized by unprecedented volatility in fuel price. But even under those conditions, the divergence between revenues and costs was less than 10% over that five-year time period[3] and represented only 1 percent of BNSF's total fuel cost over that period.[4]

Moreover, the Board's assessment of the divergence between BNSF's surcharge revenues and internal fuel costs in *Cargill* was substantially overstated because the Board's calculations did not reflect the large capital costs of fuel-efficiency initiatives that BNSF undertook during the *Cargill* analysis period, which were not reflected in the formulaic fuel costs reviewed by the Board. The Board's cost calculations reflect cost *savings* from fuel efficiency measures taken by BNSF but they do not account for the offsetting investment *costs* incurred to achieve those fuel efficiencies. As BNSF's witness Mr. Fisher explained in evidence submitted in the *Cargill* case, BNSF's annual URCS locomotive acquisition expenses alone increased by $260 million from 2006-2010 (from $624 million to $884 million) as BNSF acquired new fuel-efficient

[3] The precise percentage cannot be calculated based on public information. However, the Board noted that BNSF collected "over $2 billion" in fuel surcharges. Dividing $181 million by $2 billion produces 9%. Since BNSF collected *more than* $2 billion in revenues, the actual percentage is lower than 9%.

[4] BNSF's 10-Ks report more than $16 billion of fuel expenses over the period 2006-2010.

locomotives, but none of that $260 million dollar increase in cost was reflected in the Board's incremental cost calculations.[5]

The Board's notice initiating this proceeding also expressed a concern about the potential abuse by railroads of the "spread" between the HDF index and a railroad's internal fuel costs. The Board speculated that a railroad might try to take advantage of changes in the "spread" between the HDF index and its internal fuel price by changing the fuel surcharge mechanism when the spread decreases, but leaving the fuel surcharge alone when the spread is increasing. *Safe Harbor* at 3. There is no evidence to support the Board's concern. Indeed, BNSF's evidence in *Cargill* shows that the concern is unfounded.

In *Cargill*, BNSF explained that it designed the MBFSC to be a fair and simple cost recovery mechanism that could be understood by its shippers and easily implemented by BNSF and its shippers.[6] Once a fuel surcharge is established, frequent changes in the surcharge would only create confusion and undermine the administrability of the fuel surcharge, which BNSF consciously sought to avoid. Indeed, any effort to take advantage of changes in the spread between the HDF index and internal fuel prices, which are inherently unpredictable, would require a degree of monitoring and an ability to make quick changes in fuel surcharges that are not administratively feasible for BNSF. BNSF understood that changes in large-scale programs like a fuel surcharge take substantial time for both a railroad and its shippers to implement. As BNSF explained in the *Cargill* case, BNSF's concern about the difficulty shippers would have in changing from one surcharge to another led BNSF to hold off for more than a year in applying

[5] *See* Verified Statement of Benton Fisher at 38-39, attached to BNSF's October 24, 2011 Reply Evidence and Argument.

[6] Verified Statement of John P. Lanigan at 5-6, attached to BNSF Railway Company's October 24, 2011 Reply Evidence and Argument.

the MBFSC to carload shippers of commodities falling within BNSF's Industrial Products group.[7] Once the MBFSC was established, the only time that BNSF modified the MBFSC was to reset the strike price in 2011, and it did so only after lengthy monitoring of the performance of the fuel surcharge and planning for the change. When BNSF did change the fuel surcharge, the change was intended to accommodate its shippers' concerns that the fuel surcharge portion of the all-in transportation rate should be smaller.[8]

The Board also needs to consider the potential consequences of eliminating the safe harbor for the use of the HDF index. The Board adopted the HDF safe harbor with the support of railroads and shippers so that railroads would base their fuel surcharges on a public, transparent fuel price source. The safe harbor encourages railroads to use the HDF index because it protects them from litigation over the reasonableness of their choice of fuel price index. If the protection from litigation is removed, a railroad may be pushed to consider eliminating its fuel surcharge program or using an internal fuel price calculation to avoid claims that their choice of an index was inspired by a profit motive. The *Cargill* case shows that the prospect of such litigation over a railroad's design choices in a fuel surcharge is very real. However, reliance on internal pricing data would present its own set of issues and could create uncertainty and confusion among shippers that might well lead to further contention and litigation. Removal of the safe harbor based on misplaced concerns about the possible over-recovery of fuel costs through use of the HDF index could end up imposing new burdens and

[7] *Id*. at 5.

[8] BNSF Railway Company's October 24, 2011 Reply Evidence and Argument, at 45-46; Verified Statement of Paul B. Anderson at 33.

uncertainties on shippers that would be required to adapt to new and potentially more complicated fuel recovery mechanisms. The reasonable nexus standard is sound policy.

III. CONCLUSION

For the reasons explained above, BNSF believes that the safe harbor established in *Fuel Surcharges* for the use of the HDF index in a fuel surcharge program provides important benefits to railroads and shippers and it should be retained without modification.

Respectfully submitted,

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