

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL FUEL SURCHARGES (SAFE HARBOR)

OPENING COMMENTS OF COLORADO SPRINGS UTILITIES

Pursuant to the Decision served in the captioned proceeding on May 29, 2014, Colorado Springs Utilities ("CSU") hereby submits its comments for consideration. CSU commends the Surface Transportation Board (the "STB" or "Board") for requesting comments concerning modifications to and/or removal of the Highway Diesel Fuel ("HDF") safe harbor provisions of mileage-based railroad fuel surcharges. These comments describe several deficiencies CSU has observed with using the HDF Index as a safe harbor in judging the reasonableness of fuel surcharge programs and how the concept of safe harbor should apply. CSU's comments address several aspects of the reasonableness of fuel surcharge programs and the HDF safe harbor not raised in *Cargill, Inc. v. BNSF Railway*, STB Docket No. NOR 42120.

A. Identity and Interest of CSU

CSU is an enterprise of the City of Colorado Springs and a municipal corporation located in Colorado Springs, Colorado. It owns and operates two coal-fired plants in the general vicinity of one

another in Colorado Springs - the Drake station and the Nixon station. Coal is currently delivered to the stations from the Powder River Basin in Wyoming by the Union Pacific Railroad Company ("UP") pursuant to UP's common carrier Tariffs and Circulars, including UP Circular 6007, Item 695-E, which establishes a mileage-based fuel surcharge to be applied to CSU's transportation. This fuel surcharge formula uses changes in the HDF as a surrogate for changes in UP's actual fuel costs.

B. Problems Judging the Reasonableness of Fuel Surcharge Programs:

CSU does not object to the use of separate fuel surcharge programs to recover the incremental fuel expenses of the rail carriers, or to the use of published indexes as a surrogate of actual fuel expenses as long as they accurately and reasonably compensate the railroad for increases in its fuel costs.

Safe harbor treatment, should be limited to the application of the index and it should not apply to railroad surcharge programs generally. As explained in more detail below, the STB should separately consider the reasonableness of other aspects of fuel surcharge programs, including:

1. Implied fuel usage,
2. Locomotive efficiency gains,
3. Application of attributes, and
4. Total revenue implications.

Should the Board determine that all aspects of a fuel surcharge program, including those above, are reasonable and the railroad can demonstrate on a periodic basis (e.g. 2 years) that it collects only incremental fuel expenses independent of the actual cost of fuel, then that fuel surcharge may be afforded safe harbor treatment.

1. Fuel Surcharge Design and Implied Fuel Usage:

There are two components of the railroads' variable fuel expense, a fixed component, collected in a shipper's base transportation rate, and a variable component that consists of the fuel expenses above those collected in the base rate that are not accounted for in a rate adjustment provision, which the Board has called "incremental fuel costs." Fuel surcharge formulas are supposedly intended to permit the railroad to recover its incremental fuel costs, which is accomplished in part through the use of a formula that includes a "strike price" that triggers the application of the formula. However, both components making up total fuel cost recovery must be considered in determining whether a fuel surcharge program is reasonable. The STB's decision in *Cargill* establishes what a strike price represents, including its relationship to base rate and fuel surcharge:

In general, rail carriers can recover fuel costs in a reasonable base rate, a reasonable fuel surcharge program, or a combination of the two. The choice of the strike price constitutes the rail carrier's representation to the public of the delineation between the base rate and fuel surcharge. If a rail carrier sets the strike price at zero, it has represented to the public that it intends to recover its entire fuel cost in the fuel surcharge; if the strike price is set at infinity (i.e., it has no fuel surcharge program), the rail carrier has represented to the public that it will recover its entire fuel cost in the base rate. By choosing a strike price of \$1.25, BNSF has informed the public that its base rates will cover all fuel costs where the HDF price is less than \$1.25 per gallon, and that incremental fuel costs above \$1.25 per gallon will be recovered as a fuel surcharge. Our role in an unreasonable practice case is to assure that the rail carrier's representation is not deceptive, rather than to order the rail carrier to make a different representation. In the end, we leave the decision of the strike price to the discretion of the rail carrier. So long as its representation to the public is not deceptive and absent evidence that the carrier has abused that discretion, we will not require a rail carrier to select a different strike point.¹

At its core, fuel expense is the quantity of fuel multiplied by the unit price of that fuel.

The design of a fuel surcharge program, therefore, requires assumptions - expressed in formulas -

¹ *Cargill, Inc. v. BNSF Ry.*, STB Docket NOR 42120 (served August 12, 2013) at 16.

as to the quantity of fuel required for the movement to which the surcharge applies. While it may not be reasonable to expect 100% accuracy in the collection of incremental fuel costs for a particular movement, it should be reasonable to expect that the total incremental fuel costs being collected from a group of shippers under any given fuel surcharge program should represent actual incremental costs for their movements. Review of such assumptions should be part of the STB's determination of whether a fuel surcharge program is reasonable. CSU submits this can be accomplished as follows:

- 1) A fuel surcharge for a train movement is typically determined by the number of railcars and the miles that the railcars travel when loaded:
 - $\text{Fuel Surcharge} = \text{Surcharge per Car per Mile} \times \text{No. of Cars} \times \text{Loaded Railcar Miles}$
- 2) Because the purpose of a fuel surcharge is to recover the incremental fuel cost above the strike price for each train movement or trip, the relationship can also be shown as:
 - $\text{Fuel Surcharge} = \text{Incremental Fuel Cost} \times \text{Gallons of Fuel used per trip}$
 - $\text{Incremental Fuel Cost} = \text{Index} - \text{Strike Price}$
- 3) By rearranging the above formulas, the gallons of fuel per trip can then be determined by dividing the fuel surcharge by the incremental fuel cost:
 - $\text{Gallons per Trip} = \text{Fuel Surcharge} / \text{Incremental Fuel Cost}$

The gallons of fuel per trip can thus be quantified for specific movements. Application of this methodology will allow the Board to make “apples to apples” comparisons when assessing the reasonableness of various fuel surcharge programs designed with different attributes, strike prices, customer classes or other defined qualities. Moreover, this approach allows fuel use on individual movements to be compared to system average fuel use or to fuel use of other traffic moving under the same surcharge program. A program which, by design, over-collects fuel

quantity for all subject movements or which has excessive fuel quantity variability where some customers are excessively over-collected while others are similarly under-collected would not be reasonable. Comparisons could even be made between the fuel surcharges of different railroads since it is reasonable to expect that competitive movements would require similar quantities of fuel.

The following example illustrates the conversion of applied fuel surcharge to gallons of fuel used. This uses the actual September 2013 UP applied surcharge for a typical 130 car coal train and a 1000 mile movement under UP Tariff 6007-B Governing Rules for Regulated Traffic Item 695-E.

Example 1:

UP Tariff 6007-B Surcharge Strike Price = \$2.30

For an HDF Index = \$3.866 the Surcharge \$/Car-Mile = \$0.36

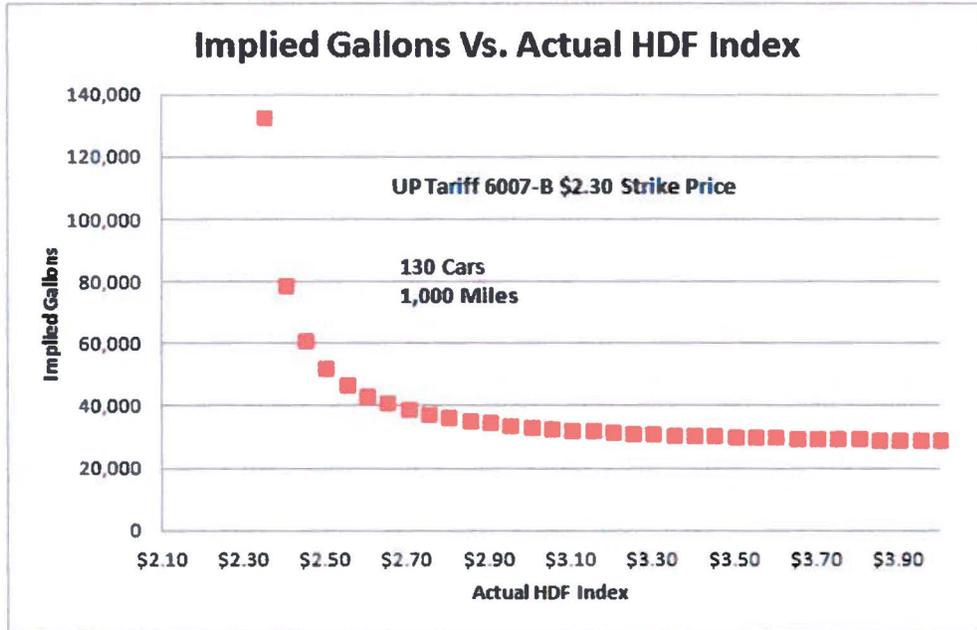
Given that the Number of Cars = 130 and Loaded Mileage = 1,000

Fuel Surcharge = $1000 \times \$0.36 \times 130 = \$46,800$

Incremental Fuel Cost \$/Gallon = $\$3.866 - \$2.30 = \$1.566$

Implied Gallons in Fuel Surcharge = $\$46,800 / \$1.566 = 29,885$

A plot of this relationship for all values of the HDF Index above the strike price illustrates how the design of this fuel surcharge program affects the quantity of implied fuel.



As designed, this fuel surcharge formula assumes significantly higher implied gallons per trip, which translates into significantly higher assumed incremental fuel costs, as the HDF Index approaches the \$2.30/gal strike price. At an HDF Index of \$2.45/gallon, twice the implied gallons are recovered through the fuel surcharge than at \$3.50/gallon. Design biases such as this illustrate the need for the Board to reconsider automatic “safe harbor” treatment of fuel surcharge programs that simply use the HDF index in their formulas.

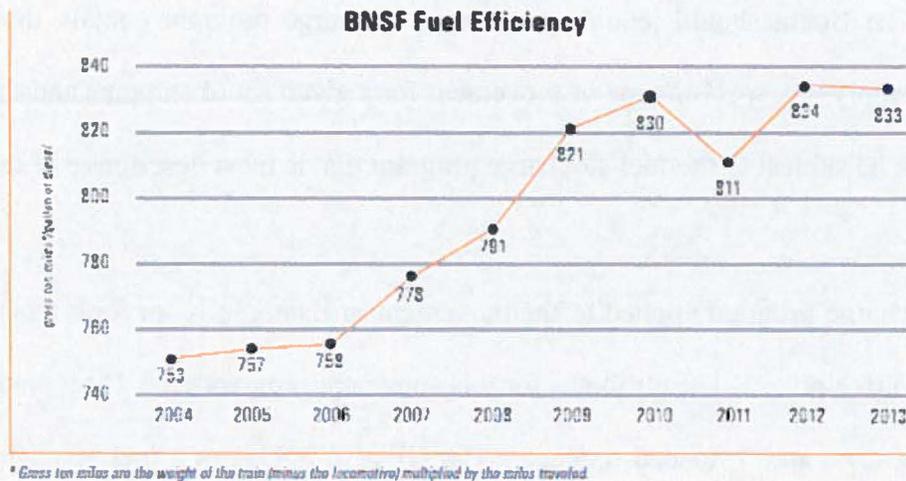
2. Fuel Surcharge Design and Locomotive Efficiency:

Another area where safe harbors may be protecting unreasonable formulas occurs when such formulas are not updated to reflect changes in locomotive efficiency. The BNSF has published the following chart indicating that its locomotive fuel efficiency has increased 10% since 2006:²

² See, <http://www.bnsf.com/about-bnsf/bnsf-review/2013/bnsf-annual-review-2013.pdf>

BNSF Fuel Efficiency

In addition to acquiring and remanufacturing more efficient locomotives, we explore technologies such as natural gas-fueled locomotives and ultra-low emission switch locomotives to help us continue to make efficient use of natural resources. Over the past 10 years, we've come a long way in our ability to move a ton of freight further with the same amount of fuel.



If fuel efficiency has increased by 10% without corresponding reductions in the quantity of fuel estimated under the fuel surcharge programs, then the surcharge formula likely overstates actual fuel usage. For classes of customers subject to fuel surcharge designs last changed prior to 2006, this over-collection may be significant.³ Therefore, CSU recommends that the Board require a periodic review of all fuel related attributes of fuel surcharge programs to ensure that actual incremental fuel costs are being recovered.

3. Application of Defined Attributes:

The railroads have freedom to design their fuel surcharge programs using a variety of movement attributes that may or may not have a reasonable nexus to fuel consumption.

³ Significant drivers of improved fuel efficiency include locomotive technology, engineer training, and improved operations. The use of more efficient switching locomotives reduces switching fuel by as much as 37% while automatic start-stop equipment can save 15-24 gallons of fuel per day per locomotive. The UP's voluntary Fuel Masters' program which rewards engineers who operate trains most efficiently may cut fuel use by 5%.

Attributes often include the number of cars, loaded mileage, commodity type, and origination point. In general, if there too few defined attributes in a surcharge program, the program may not sufficiently correlate to the fuel expenses associated with certain movements to which the surcharge is applied. The Board should require that a fuel surcharge program contain those attributes that generally apply to a specific type of movement for a given set of shippers and that any particular movement be subject to the fuel surcharge program that is most descriptive of that movement.

The UP fuel surcharge program applied to the movement in Example 1, set forth above, has a \$2.30 HDF Index strike price.⁴ The attributes for this surcharge program are: 1) regulated traffic, 2) the number of cars, and 3) loaded mileage. The UP also publishes a fuel surcharge program for Coal Trains Originating in Wyoming under Circular 6603-C. The fuel surcharge published in this document has a \$1.35 HDF Index strike price. The attributes of this fuel surcharge are: 1) unit coal trains, 2) originating in Wyoming, and 3) the number of cars, and 4) loaded miles.

It is logical that surcharge programs for trains originating in Wyoming would have similar implied fuel usage under a \$1.35 strike price fuel surcharge to the implied fuel usage from a \$2.30 strike price for regulated traffic originating in Wyoming. The following example, however, indicates this may not be the case. Using the same methodology in Example 1 with \$1.35 HDF strike price, the implied fuel usage is as follows:

Example 2:

PRB Originations Surcharge Strike Price = \$1.35

For an HDF Index = \$3.866 the Surcharge \$/Car-Mile = \$0.43

Given that the Number of Cars = 130 and Loaded Mileage = 1,000

Fuel Surcharge = 1,000 x \$0.43 x 130 = \$55,900

⁴ Example 1 applies UP Tariff 6007-B Governing Rules for Regulated Traffic Item 695-E.

$$\text{Incremental Fuel Cost \$/Gallon} = \$3.866 - \$1.35 = \$2.516$$

$$\text{Implied Gallons in Fuel Surcharge} = \$55,900 / \$2.516 = 22,218$$

A regulated shipper pays for 29,885 gallons of fuel (Example 1) for its PRB movement; however, a contract coal shipper with a similar movement would be charged for 22,218 gallons of fuel (Example 2). It is not reasonable that a unit coal train shipper would be required to pay for 35% more fuel simply because it is served under a regulated traffic tariff.

4. Relationship to Total Fuel Revenue:

The UP has stated that different strike prices for a fuel surcharge program should not affect the total fuel revenue collected.⁵ The implication of such a statement is that the quantity of fuel collected in the base rate is equal to the quantity of fuel collected under the fuel surcharge. STB Quarterly Fuel Surcharge Reports show that the UP pays roughly \$0.76 less per gallon than the HDF Index for fuel (the “spread”). Because the fuel surcharge collects the incremental cost of fuel above the strike price, then the amount collected in the base rate would be the strike price less the spread. For a \$2.30 HDF strike (Example 1 above) this equates to \$1.54 per gallon. For a \$1.35 strike price (Example 2 above) this equates to \$0.59 per gallon.

The total revenue collected for Example 1 ($29,885 \times \$1.54 + \$46,800 = \$92,833$) is 35% greater than the total revenue collected under the program detailed in Example 2 ($22,218 \times \$0.59 + \$55,900 = \$69,009$) for the same exact attributes and movement. However, the fuel surcharge for Example 1 (\$46,800) is 20% lower at the fuel surcharge collected for Example 2 (\$55,900).

These examples illustrate how a program’s implementing formulas affect the total fuel revenue collected and why the Board must consider both base and surcharge revenue when

⁵ UP 2008 SEC 10-K filing

determining reasonableness of the applicability of any fuel surcharge program. The table below summarizes the differences from the two examples discussed more fully above:

	Strike Price	Fuel Surcharge	Base Revenue	Total Revenue
Example 1- Regulated	\$2.30	\$46,800	\$46,023	\$92,823
Example 2- PRB Orig	\$1.35	\$55,900	\$13,109	\$69,009

CONCLUSION

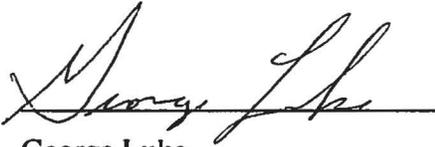
The Board has stated that a fuel surcharge program is meant to recover a rail carrier's "incremental fuel costs." By implementing a fuel surcharge program, a railroad effectively represents that fuel is a pass through charge. Because surcharge programs are intended only to remove the railroads' fuel cost variability and the associated risk, the railroads should not profit from such programs. Moreover, CSU believes that any surcharge program that does not refund fuel costs when the HDF Index falls below the strike price should not be considered to be reasonable.

A fuel surcharge program should not be afforded safe harbor status simply because it utilizes a specific index (i.e. the HDF Index). Instead, the STB should review all attributes of a fuel surcharge program and require the railroads to demonstrate that the surcharge program design, how it is being applied, the fuel use, and the incremental revenue collected are reasonable.

Given the direct relationship between base rates and the fuel surcharge, modifications to fuel surcharge programs pose certain challenges. Nonetheless, because a fuel surcharge program is intended to only collect incremental fuel costs, a periodic review of such programs by the STB, taking into account the actual quantity of fuel implied by the surcharge program as well as the total revenue collected, is justified. Upon completion of such review, any index or other

attribute that no longer bears a reasonable nexus to fuel consumption should be replaced with more accurate measures. Only when the Board has determined that all aspects of a fuel surcharge program are reasonable, and that the railroad demonstrates on a periodic basis that it collects only incremental fuel expenses, should a fuel surcharge be afforded safe harbor treatment.

RESPECTFULLY SUBMITTED

A handwritten signature in cursive script, appearing to read "George Luke", written over a horizontal line.

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