BEFORE THE
SURFACE TRANSPORATION BOARD

EX PARTE NO. 661 (Sub No. 2)

RAIL FUEL SURCHARGES (SAFE HARBOR)

COMMENTS OF
CANADIAN NATIONAL RAILWAY COMPANY

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By decision served May 29, 2014, the Board issued an advance notice of proposed rulemaking for interested parties to comment on whether the "safe harbor" provided by the agency's fuel surcharge rules should be modified or removed. Canadian National Railway Company, on behalf of its U.S. rail operating affiliates (collectively, "CN"), submits the following comments.

BACKGROUND

More than a decade ago, in order to manage increasingly volatile fuel prices and ease the burdens on our customers and the company from frequent adjustments to its base rates, CN, like many other rail carriers, established fuel surcharges. Fuel surcharges are a separately identified component of the total rate, designed to capture more efficiently the rapid and significant changes in carrier fuel costs. CN and many other carriers initially established their fuel surcharges as a percentage of their base rates.

Concerned that a rate-based surcharge approach was not sufficiently related to the increase in fuel costs associated with particular traffic, the Board held a hearing on the issue in May 2006. In *Rail Fuel Surcharges*, Docket No. Ex Parte No. 661 (STB served Jan. 26, 2007), the Board subsequently concluded that promulgating fuel surcharges on

STB-regulated traffic as a percentage of a base rate is an unreasonable practice. Without mandating a methodology, the Board determined that fuel surcharges based on mileage and/or weight would more properly approximate the impact of changes in fuel costs, as the methodology used to calculate the fuel surcharge must have a "reasonable nexus to fuel consumption." But the Board also recognized that requiring railroads to incorporate every single factor that might affect fuel consumption would be impracticable. To help approximate changes in the carriers' fuel costs, the Board concluded that the Highway Diesel Fuel (HDF) Index[1] sufficiently reflected changes in rail industry fuel costs for carriers to rely on that index as a proxy for measuring changes in their internal fuel costs and adjusting freight rates accordingly through a fuel surcharge mechanism. In response, CN established mileage-based fuel surcharges based on the HDF Index, which it has relied upon ever since.

Recently, the Board examined a complaint brought by Cargill, Inc. claiming that mileage-based fuel surcharges established by BNSF Railway Company ("BNSF") constituted an unreasonable practice because BNSF's fuel surcharge revenue significantly exceeded its internal fuel costs. *Cargill, Inc. v. BNSF Ry.*, NOR 42140 (STB served Aug 12, 2013) ("*Cargill*"). The Board dismissed Cargill's complaint based on its findings that BNSF had measured changes in its fuel costs for its surcharge using the HDF Index that the Board had established as a safe harbor, and that the changes in surcharge revenues BNSF had collected closely approximated the changes in fuel costs as measured by that index.

The Board found no evidence to suggest that BNSF had taken unreasonable advantage of the safe harbor. Nonetheless, the growing spread the Board observed

[1] Energy Information Administration U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon).

between changes in the average retail price per gallon reflected in the HDF index and changes in the wholesale price per gallon actually paid by BNSF, raised questions for the agency about the continuing use of the HDF Index as a safe harbor. It seeks comments on those concerns here.

DISCUSSION

CN respectfully submits that the Board should not modify or remove the safe harbor provided by the HDF Index. The essential rationale and necessity for fuel surcharges – the volatility of fuel prices – remains. In ordering rail carriers in 2007 to move away from percentage-of-rate-based surcharges to mileage-based surcharges (or other surcharges that reasonably reflect the fluctuations in fuel costs for transporting particular traffic), the Board cleared the way for the use of surcharges as a reliable and efficient rate adjustment mechanism.

CN understands the Board's present concerns, but believes that changes to this well-established mechanism are unwarranted and would be counterproductive. A safe harbor based on an independently compiled index is essential to assure that CN and its thousands of customers have an efficient, fair, and transparent means to account for changes in fuel costs without frequent changes to base rates and terms for transportation.

The HDF Index has worked well for CN as a safe harbor measure of fuel cost changes, with no significant problems. CN last rebased its mileage-based fuel surcharges in the second quarter of 2008. Since that time, changes in the HDF Index and in CN's average fuel costs have generally tracked closely, so that the difference between average retail fuel prices reflected in the HDF Index and CN's actual average fuel costs has remained relatively stable over that time. Therefore, the HDF Index has been and continues to remain a reliable and reasonable proxy for changes in CN's fuel costs. Unless or until another index emerges as a superior proxy – and CN knows of none – the HDF Index should remain as a safe harbor.

The benefits to the Board, rail carriers, and shippers of providing the authoritative HDF Index as a safe harbor are substantial. It provides a strong incentive for use of that index in order to benefit from the protection, reliability, and credibility that flows from use of it. The *Cargill* proceeding aside, it also reduces the need for regulatory intervention, with its attendant burdens.

Moreover, the risk of the potential abuses that appear to be most troubling to the Board – that a rail carrier's internal incremental fuel costs rising relative to those in the HDF Index would prompt the carrier to raise its fuel surcharge above what the index would provide, or that a decline of its fuel costs relative to those in the Index would not lead to a surcharge reduction – appear to be too insubstantial to justify abandoning the HPF Index-based safe harbor. CN's does not view and has not sought to use its fuel surcharge program as a profit center. CN's objective and practice since the implementation of its fuel surcharges, whether rate or mileage-based, has been to establish surcharges that allow it to reasonably recover in the aggregate its changing fuel costs.

There are also important realities and practicalities to consider. As CN and other parties have previously pointed out, given the complexities and dynamics of fuel acquisition by rail carriers and fuel consumption for individual shippers, a mileage-based fuel surcharge can reasonably capture variations in a carrier's internal fuel costs when tied to the HDF Index, but no surcharge approach based on an index can be perfect.

Variations in individual carrier fuel costs versus any index are to be expected, and fuel costs per car-mile can vary significantly from shipper to shipper depending on weight, speed, intensity of local switching, empty return ratio, track conditions, geography, and overall operating conditions, even for movements of the same commodity over the same distance. Therefore, implicit in the Board's acceptance of mileage-based surcharges using the HDF Index is the acceptance of some variation in the spread between that index and individual carrier fuel costs and some differential between fuel cost recovery through the surcharge and actual carrier fuel costs. Minor variations in either respect should not be cause for concern.

In sum, while the Board should continue monitoring fuel surcharges, CN respectfully submits that modifications to the HDF Index or its removal are not warranted. The benefits in administration, fairness, simplicity, and reliability to both shippers and carriers from continued reliance on the HDF Index as a reasonable proxy for changing fuel costs are very substantial and very much in the public interest. The Board's decision in 2007 in favor of the use of mileage-based surcharges tied to the HDF Index significantly and successfully satisfied the agency's regulatory imperatives for more reasonable and fair fuel surcharge programs; the significant changes to carrier and customer accounting and invoicing systems, and to industry systems to accommodate mileage surcharges for interline traffic, have been made; and the current fuel surcharge programs have stood the test of time.

Respectfully submitted,

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