UNITED STATES OF AMERICA

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SURFACE TRANSPORTATION BOARD

PUBLIC HEARING

RAIL FUEL SURCHARGES

EX PARTE 661

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THURSDAY, MAY 11, 2006

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The Public Hearing convened in Hearing Suite 760, 1925 K Street, N.W., Washington, D.C. 20423-0001, pursuant to notice at 9:00 a.m., Chairman Douglas Buttrey presiding.

SURFACE TRANSPORTATION MEMBERS PRESENT:

DOUGLAS BUTTREY Chairman
FRANCIS MULVEY Vice Chairman

PANELISTS:

GOVERNOR BRIAN SCHWEITZERA

TERRY WHITESIDE,	WHEAT & BARLEY COMMISSIONS
STEVEN STREGE	NORTH DAKOTA GRAIN DEALERS ASSOCIATION
DAN MACK	NATIONAL GRAIN & FEED ASSOCIATION
JUDY GILLIES	THE FERTILIZER INSTITUTE
ERIC WILKEY	TRANSPORTATION, ELEVATOR, & GRAIN MERCHANTS ASSOCIATION
TERRY VOSS	AG PROCESSING
GEORGE TELFER	ALLIANCE OF AUTOMOBILE MANUFACTURERS/DAIMLER CHRYSLER

ROBERT NEFF	AMEREN ENERGY FUELS & SERVICES
JAY ROMAN	AMEREN ENERGY FUELS & SERVICES/ESCALATION CONSULTANTS
THOMAS CROWLEY	WESTERN COAL TRAFFIC LEAGUE
PETER PFOHL	WESTERN COAL TRAFFIC LEAGUE
BILL MOHL	ENTERGY CORPORATION
THOMAS WILCOX	THE AES CORPORATION
AMES HELLER	CONCERNED CAPTIVE COAL SHIPPERS
MICHAEL LOFTUS	CONCERNED CAPTIVE COAL SHIPPERS
STEPHEN POCSIK	TOTAL PETROCHEMICALS USA, INC.
MICHAEL MCBRIDE	TOTAL PETROCHEMICALS USA, INC./EDISON ELECTRIC INSTITUTE
STEVE SHARP	ARKANSAS ELECTRIC COOPERATIVE CORP.
DIANE ELHAKIM	DEGUSSA CORPORATION
DAVID WEISEL	POTLATCH FOREST PRODUCT CORP.
JAMES CONWAY	GRIFFIN INDUSTRIES
DANIEL SLAVIN	GRANITEROCK
JOHN FICKER	THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE
CURT WARFEL	THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE
THOMAS SCHICK	AMERICAN CHEMISTRY COUNCIL
CHARLES LINDERMAN	EDISON ELECTRIC INSTITUTE
TOM HUNT	BNSF RAILWAY COMPANY
JAMES FOOTE	CANADIAN NATIONAL RAILWAY CO.
MARCELLA SZEL	CANADIAN PACIFIC RAILWAY
CHRISTOPHER JENKINS	CSX TRANSPORTATION
DONALD SEALE	NORFOLK SOUTHERN RAILWAY CO.
ROBERT KNIGHT	UNION PACIFIC RAILROAD CO.
ROBERT DINGMAN	OIL CREEK & TITUSVILLE LINES
TOM O'CONNOR	SNAVELY KING MAJOROS O'CONNOR & LEE, INC.
MAZHAR ALI AWAN	TRANSPORTATION ECONOMICS, INC.
SANDRA DEARDEN	HIGHROAD CONSULTING, LTD.
MICHAEL BEHE	FREIGHT RESOURCES NETWORK, LLC.

A G E N D A

P-R-O-C-E-E-D-I-N-G-S

9:01 a.m.

CHAIRMAN BUTTREY: Well, good morning to everyone. I'd like to call this hearing to order and welcome everyone here today for the Surface Transportation Board's Public Hearing on Rail Fuel Surcharges and the proceeding entitled STB Ex Parte No. 661.

I'm pleased that today's hearing is being simultaneously video webcast available for viewing through the Board's website.

I'd like to welcome all those who are tuned in and watching over the Internet in addition to those who are here in person with us today.

Vice Chairman Mulvey and I are keenly aware of the concerns that have been raised regarding the level of rail fuel surcharges, the way in which they are calculated, how they are levied and who is or is not paying them.

After considerable thought and discussion, we concluded that a public hearing could be very beneficial to provide shippers the opportunity to publicly comment on the impact of these added charges and their effect on the competitiveness of rail shipped commodities and merchandise and to give each of the major railroads the opportunity to present accurate information about their individual surcharges.

We are all painfully aware that fuel prices are at an all-time high. Today volatility of fuel prices and supply seems to be the norm not the exception. We all deal with it in our daily lives as we buy gasoline for our personal vehicles. But for the railroads, the sticker shock and unpredictability of the current fuel environment has an even bigger impact.

Our railroads are a relatively fuel efficient way to move freight. And their fuel efficiency has been increasing in recent years as newer locomotives are added to the fleet. The cost of fuel is a very significant operating expense for railroads. Their U.S. operation consume several billions of gallons of diesel fuel each year.

I have not heard anyone suggest that

railroads should not be able to respond to the dramatic increases in their fuel cost by imposing surcharges. After all, for the primary freight moving competitors, the trucking industry, diesel fuel surcharges are an accepted practice.

Rather, the concern seems to be focused more on how these rail fuel surcharges are calculated and applied. Or put another way, with a transparency, predictability and fairness of the process.

We are not without some guidance in this area. This is not the first time Federal regulatory process has struggled with fuel surcharge issues. Our predecessor, the Interstate Commerce Commission faced a near crisis situation when diesel fuel prices escalated sharply after OPEC imposed its 1973 oil embargo.

Back then the ICC had jurisdiction over motor carrier rates and practices as well as rail. The rapid escalation of fuel prices hit the independent truckers especially hard. Those owner-operators were typically under contract to perform transportation of regulated commodities for a carrier with operating authority for which the owner-operator received a fixed percentage of the transportation rate. The transportation rate was set by the regulated carrier.

The owner/operator was responsible for paying all initial costs connected with providing the transportation including fuel out of its fixed percentage of the transportation rate.

Fuel cost rose rapidly in the late 1970s and the owner/operators faced a severe cost crunch. The ICC authorized the regulated motor carriers to impose fuel surcharges on short notice, but this was not enough to solve the problem.

Because the carriers did not pay for the fuel, they had little incentive to impose surcharges promptly. And not all of the surcharges passed through to the owner/operator because of the terms of the contracts.

Several interim steps through the late 1970s also proved insufficient. The ICC finally mandated that carriers must pass through to their owner/operators the maximum allowable surcharge amount regardless of the terms of their agreements with the owner/operators.

I'll read that again. After several interim steps through the late 1970s proved insufficient. The ICC finally mandated that carriers must pass through to their owner/operators the maximum allowable surcharge amount regardless of the terms of their agreements with the owner/operators.

This order was issued by the ICC in 1981 in a proceeding called Ex Parte Number 311, Sub-part 4.

Although the ICC issued this order with the best of intentions to help hard-pressed owner/operators, the Federal Court ultimately struck it down as being beyond the agency's authority.

In a 1983 holding, the 5th Circuit Court of Appeals found that the ICC had exceeded its statutory authority when it intruded so far into the specifics of how the industry controls surcharges to recover increased fuel cost. And, in effect, altered the terms of the private agreements between the carriers and the owner/operators. This decision which is printed at 698 F.2d, 1266, is some of the only court guidance we have in this area.

While the facts of that 1983 case are different from the situation before us today in some respects, the two situations are very similar and they both involve indexed mileage-based transportation fuel surcharges. The Court's basic message is a good one to keep in mind as we proceed here today. The agency must be mindful of the limits on its statutory authority.

I think it's also instructive to consider what the court did not have a problem with in this case. It clearly did not have a problem with the idea of fuel surcharges per se to enable carriers to cope with fluctuating fuel costs.

With that background, let's turn to today's hearing. We have a substantial list of shippers, railroads and other interested parties that will testify. Some of the questions that may be raised include the nature of the various rail surcharges, how they are applied, how much revenue they generate, how different classes of traffic are affected, what index is used for escalation, and how the Board should treat rail fuel surcharges in the uniform rail costing system or URCs.

The Board, of course, has an open mind about these issues. All the testimony, both oral and written, will be given full consideration at this proceeding. I would also like to note that the Board has received comments from two members of Congress, Senator Conrad Burns and Senator Byron Dorgan. They requested that their comments be put in the record for this proceeding and they have been as will comments that may be received later from any other members of Congress.

I plan to run straight through the witness list today in order until about noon. We'll break for lunch and resume an afternoon session that will begin promptly at 1:00 p.m. The hearing will continue until all speakers have been heard.

I will now turn to Vice Chairman Mulvey for his opening statement.

Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: Thank you, Chairman

Buttrey. And good morning, and let me add my welcome to our panelists and those attending the hearing today. We have a full house today.

As the Chairman noted the Board does, indeed, have an open mind with regard to the issue of fuel surcharges. What troubles the shippers, why the railroads need them, and how assessing them and reporting them could be improved.

We're holding this hearing today to gather information about how various fuel surcharge programs work, to provide a forum to hear the views of all the parties and to open a dialogue between the parties that will help us move towards resolving the problems created by fuel surcharges.

From the shipper perspective, I can fully understand their desire to be treated fairly. Their call for more transparency in the process is reasonable as are their concerns about how fuel surcharges are developed and applied.

And as we stated in our March 14th notice of this hearing, the Board is most interested in the issue as to whether railroad fuel surcharges are being set in such a manner so that they are used to recover only the increased costs for the particular movements to which the surcharge is applied.

Certainly, no one is suggesting that railroads should not be allowed to recoup their increased fuel costs. Simply browsing through the many filings in this proceeding, shows general shipper support for a fair fuel surcharge program.

But the railroads run into problems with their shippers when the surcharges appear to be profit centers, rather than cost recovery mechanisms, and when there is a lack of clear correlation to increases in the cost of fuel actually paid by the railroads and actually used for the particular movements.

I believe the Board's authority in this area depends largely on how the surcharges are characterized. Prior decisions on surcharges, while providing some guidance, do not give us a clear-cut answer as the circumstances are sufficiently different today from those in the prior decisions.

While engaging in today's collective endeavor to shed some light on the issues surrounding railroad surcharge programs, it is my hope that we will establish a substantial record, documenting the concerns of shippers, suggestions for improvement on the part of the railroads and ways in which the STB can help the railroads and shippers to work together to find mutually acceptable solutions.

Thank you.

CHAIRMAN BUTTREY: Thank you, Vice Chairman Mulvey.

I believe we're ready to start with our first witness. It's my pleasure at this time to welcome the Governor of Montana, the Honorable Brian Schweitzer to testify.

Governor Schweitzer.

And if you have anybody with you that you would like to introduce, you're certainly welcome to do that as well.

GOVERNOR SCHWEITZER: Thank you very much.

Mr. Chairman, Vice Chairman Mulvey, Staff of the Board, I'd like to thank you for the opportunity and welcome the chance to present the comments on railroad fuel surcharges in this area.

I stand before you--I'm actually sitting down, as the Governor of Montana, but also as a farm producer, a businessman and most importantly as a citizen who has had many years of experience dealing with our railroad problems in Montana.

All four of my grandparents arrived in Montana on Jim Hill's Railroad. They got that ride for nothing. He put them on a homesteader's box car from Ellis Island, brought them out to Montana and that was in 1909. That's the only free ride we got on the railroad. We've been paying for it ever since.

I could have come here with a bunch of big-shot lawyers, but I see the room is full of them already, and talk to you about all of the issues that only an attorney would understand. But instead I came here personally and I want to demonstrate my concern for the lack of focus and energy the past Board has shown about the continuing plight of American industry in the rising of monopoly power of the railroads.

I want to thank personally Chairman Buttrey for his recent visits to Montana to view for himself the problems that we are facing with a single market dominated railroad. You, Mr. Chairman, and Vice Chairman Mulvey, and any Board staff are welcome to come to Montana at my personal invitation and I'll assure you that the next time you come, there will be some time for fishing and fooling around. We worked pretty hard the last couple of times. The next time you'll get a chance to do a little fishing.

The state of the railroad situation in Montana can definitely be described as a spirit of hope and a story of survival. Montana ranks third among the states in whole wheat production. Specifically, it ranks third in spring wheat production. Second in durum production and Montana also ranks third in barley production, third in lentils, third in dry animal feed, second hog feed production, second in flax.

Montana originated over 37 million tons of rail traffic. It's ranked 17^{th} in the nation. At the same time, Montana bridged 78 million tons of rail traffic.

Our spirit of hope is buoyed by the fact that, well, things can't get much worse. And Montana is tough. We'll seek compromise solutions to our most vexing problems. Our story of survival is centered around the fact that this Board and its predecessor, the ICC, have allowed the creation of a monopoly in Montana in a land where the goods we produce are mostly bulk commodities and the movement by rail to points outside of Montana.

Now, Montana is dominated by a single railroad, BNSF, which controls 94 percent of Montana's rail system. This makes Montana the number one rail-dominated state in the country.

After Montana at 94 percent is Delaware at 83, followed by Idaho at 80 and North Dakota at 66, South Dakota at 54. BNSF controls over 91 percent of the tonnage hauled out of Montana, 92 percent of the rail revenue in the state and since 1975, Montana has seen over 1,900 miles of rail line abandoned. 1,900 miles of rail abandoned in Montana. Over 37 percent of our rail miles, because there's no rail to rail competition.

The distances are large, very large. To put the vastness in perspective, if one were to place one quarter of Montana over Washington, D.C., the outer corner would extend all the way to Chicago.

Montana's top four industrial activities are agriculture, tourism, mining and lumber. Montana's economy and wealth is thus highly dependent upon production and shipment of commodities. In order for these commodities to have high value in Montana, they must be shipped to points outside the state or country to market. It is this absolute reliance upon good, affordable and efficient transportation that brings me here today.

We hope for a better day where fairness and regulation and more rail competition will rule the land. Meanwhile, we struggle every day trying to survive under a monopoly.

Here's the math. Large land area plus low population, plus lack of large internal markets, plus long distance for markets, plus raw commodity economy equals heavy reliance on the rails.

Our Montana concerns are founded on four points. Rail transportation is vitally important to Montana's raw commodity based economy. Montana's rail system increasingly serves simply as a bridge for long distance traffic. Increasing numbers of short lines and abandonments have reduced Montan's shipper access to class one rail service and domination of one class railroad continues as the number one freight issue in Montana.

Well, shippers used to take cases to the Surface Transportation Board expecting to get fair and balanced treatment. But shippers haven't found any relief for a long, long time. They have instead become so discouraged by the past few years that only a very few have the funds or confidence to bring a case.

Faced with the effects of railroad monopoly that were withering away, the key element of Montana's economy, Montana in 1980 filed a class action case. We pursued the McCarty Farms case for 17 years. In this case, the ICC on December 14th, 1984, found that BN had market domination and that its rates were unreasonable. The administrative law judge further found that the rates were higher than 300 percent of the variable costs.

The State of Montana spent $3.1 million, that's the bad news. The good news for all of you in this room was spent on lawyers. And we found the rates were not excessive.

This Board ruled against the farm producers in Montana after changing the regulatory standards twice. Regulatory oversight of the railroads or lack of it affects everything we do in Montana every single day.

Montana has borne the freight charges on commodities produced in Montana. We have no choice. You may not want to hear it, but from where we stand, this Board with its past actions and those of the former ICC, created the railroad mess in Montana and we have done little to fix it.

We didn't want a single monopoly railroad in our state. We stated that over and over again in the hearings that preceded the creation of Burlington Northern. But your predecessors made it happen and they allowed the three major transcontinental railroads to cross Montana to form a single company in Burlington Northern. Montana went from four healthy transcontinental railroads in 1970 to one today that dominates the entire state.

Then when the Milwaukee Road, ICC's designated competitor for BN failed, just nine years later, no one from this Board or the ICC came out to Montana to clean up the monopoly mess that they created and we live with it every day.

I'm here to tell you that we are tired of paying more than our fair share. We in Montana are supportive of fair treatment of all rail shippers. We're tired of being abused by poor service. We're tired of having a monopoly railroad service, only rail lines that they want to service and not the railroads important to the citizens of Montana. And even though are still in service, they still use the railroad lines in Montana to hide from the tax man by storing thousands of cars on the light density lines and Chairman Buttrey, you saw those thousands of cars when you were in Montana.

They are unable to service the customers on those locked lines and later used this lack of service for grounds for abandonment and you saw that at Big Sandy where we had cars lined up from Big Sandy nearly to Haver and now we're trying to abandon that line.

Chairman Buttrey on his last visit to my State saw this firsthand and heard directly from the people of Montana about their struggles with the railroad.

I realize that you at the Board will see in these remarks areas that are not germane to the proceedings at hand. But you also have to realize that it's not every day that a governor gets a chance to talk to you. And so I thought I might share a few other things with you.

The fuel surcharge issues is a perfect example of what has gone awry with the monopoly railroads. In Montana we pay some of the highest freight rates in the nation regardless of business. Why? Well, Chairman Buttery heard why when he came out to Montana. Everyone of those farmers that pay these rates, they know why. It's lack of rail to rail competition. In Montana the car shortages start early and last longer. Why? Lack of rail competition.

When BNSF and UP introduced the concept of fuel surcharges several years ago, they based their fuel surcharges on rate levels. Thus, those who were the most captive who had paid the highest rates paid the most fuel surcharge. Montana is tired of paying more for their fair share and that was an unreasonable practice.

After a great deal of rhetoric and exchange with BNSF over a number of years, BNSF announced for direct shipments from Montana, wheat and barley, that there would be a mileage-based fuel surcharge program because it would be inherently fair to those with elevated rate levels. This amounted to recognition by BNSF that rate-based surcharges are an unfair rate practice.

And my transportation advisors told me before we saw that devil in the details from BNSF that Montana would be paying more after a switch to a mileage-based fuel surcharge than they were under the revenue-based fuel surcharge. And you know what? We got our money's worth. They were right.

Today, Montana rail rates are just as high or higher with the mileage-based fuel charges than they were under the revenue-based fuel charges. Why? Well, because BNSF simply raised the underlying rates and then applied a slightly smaller mileage-based fuel surcharge than the revenue-based fuel surcharge. Plus, BNSF is again making more money while we in Montana are again subsidizing the rest of the rail shippers and railroads in this country.

Yes. BNSF has stated that mileage-based fuel charges would collect essentially the same amount of surcharge as the revenue-based programs. In an area such as Montana where the rate levels are among the highest in the nation, the switch to a mile-based fuel charge in Montana should show substantial relief from excessive rate-based fuel charges. The switch resulted in higher rates. And that makes my point to show that railroads continue to over-collect from Montana.

I want you at the Board to understand that the truth is that the transportation rates we pay include all charges. Transportation to the grain elevators, handling, rail rate and fuel surcharges and all of those charges continue to go up and up.

BNSF is contemplating modifying and reducing the effect of mile-based fuel surcharges on those shippers but not in areas like Montana where they have a monopoly. Again, Montana is paying more than our fair share and we are darn tired of that. Since I'm in Washington, D.C., I said darn tired.

It is my view that when the Stagger Rail Act of 1980 was passed Congress was seeking two major outcomes by focusing on deregulation. The charge was to (1) produce a stronger rail industry than the one that we had at the time, plagued with multiple bankruptcies and (2) to be protective of the captive rail customers from potential abuse that might occur due to decreased regulatory oversight and the inevitable consolidations that would occur in the future.

There is a call for balance in this bill from Congress.

Chairman Buttrey and I have visited at length about this increased rail to rail competition that was called for by Congress in the Staggers Act in Title 49, Subtitle IV, Part A, Chapter 101, Section 10101, Rail Transportation Policy. The word "competition" is utilized in four of the 15 parts.

Number one "To allow to the maximum extent possible competition and the demand for services to establish reasonable rates for transportation by the rail."

Number four, "To ensure the development and continuation of a sound railroad system with effective competition among rail carriers and with other modes to meet the need to the public and the national defense."

Five, "To foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes."

And number six part "To maintain reasonable rates when there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and track capital."

The most pressing question and the heart of this exploration is what is best to address the public interest? After all, protecting the public interest is clearly what Congress desires when it makes changes in regulatory schemes. In our mind, the rail customer, the public, needs a competitive rail transportation system that provides fairly priced, safe and reliable service.

Are fuel surcharges that recover more than the system-wide fuel cost increases incurred by the railroad reasonable carrier practice? No.

Are fuel surcharges that recover more fuel surcharge for a particular movement than has occurred by a railroad, a reasonable carrier practice? Again, no way.

Are fuel surcharges that are levied on only a part of the rail shippers at levels that return all or more than all of the fuel price increases for the whole railroad system, a reasonable carrier practice? No.

Are fuel surcharges levied on Montana rail shippers who have no alternative other than rail movement that compensate the railroad for the lack of fuel surcharges on other railroad movements a reasonable carrier practice? Again, no.

One shipper should not be charged more than the actual fuel allocated to the movement of their goods.

When the BNSF's fourth quarter 2005 price for fuel was $1.69 a gallon. At the same time in December 2005,they were assessed an 18.5 fuel surcharge on movements from Montana. On movement from Great Falls, Montana, to the Pacific Northwest in dollars per car, the rate was $3,029 per car.

My costing experts, and we pay them a lot of money, tell me that the estimated fuel cost on BNSF for each gross ton mile per gallon is $758, based on published fourth quarter 2005.

So, for an 882 mile haul, the estimated fuel cost would be about $315.60. Yet, the BNSF was collecting an 18.5 percent fuel surcharge based upon a rate of $560.36, which is a surcharge revenue fuel ratio of 1.78.

And the BNSF was and continues to assess the fuel surcharges that are greater than the actual fuel costs on movements from Montana even under the mileage-based fuel surcharge system. An unfair rate practice.

Remember that when BNSF in January of 2006 changed to a mileage-based fuel surcharge for these same Montana movements, our rates actually increased again.

And Montana needs fairness in pricing by railroads. They should not have to continue to bear more than their fair share. And that is why this Board exists, to bring fairness of practice to the markets dominated by a monopoly railroad industry.

A lot of change is needed. The railroad needs to price fairly. I am hopeful that you will find that the way the fuel surcharges are being implemented is an unfair rate practice and that you will open a rule-making proceeding to instill fairness to the marketplace.

I hope that you will see a new day at this Board with you, Chairman Buttrey, the great fisherman, and Vice Chairman Mulvey initiating a more balanced approach that was called for by the Congress in the

1980 Staggers Rail Act, because there are so many lawyers here and they're billing so many customers, I'm not going to go on any further. But I will enter the rest of my remarks in the written testimony.

Thank you very much for this opportunity and we'll see you in Montana. Thank you.

CHAIRMAN BUTTREY: Thank you, Governor, very much for your testimony today. I'd like to also thank you personally for the courtesy you extended me on my two visits to Montana and I'm sure we'll be seeing you out there again sometime in the future.

We're trying very much to keep this hearing on schedule. I know you have other appointments today, but I want to give the Vice Chairman a chance to say anything he might like to say to you.

Thanks for coming such a long way to be here.

VICE CHAIRMAN MULVEY: Thank you, Chairman Buttrey.

Like the Chairman, I've also spent some time in Montana. I lived there for awhile back in the late `60s, early `70s and it's a beautiful, beautiful state. I've been there a number of times since then.

I'm not one of the lawyers in the room. I'm an economist. And as an economist I believe heartily in competition. My whole career has been spent promoting competition and trying to see what we could do to offset the evils of barriers to entry and monopoly. And I feel the same way about the railroad industry in this country. We need to make sure that competition prevails and when competition does not prevail, the shippers are treated fairly.

Both Chairman Buttrey and I are dedicated to the proposition that we are responsible for balancing the interest of shippers for reasonable rates with the needs of the railroads to earn adequate returns. And we are looking at the way the Board does things and the way in which we approach our analyses to make a process that's as fair as possible and to make sure that shippers receive justice before the Board where justice is needed.

So, with that I thank you for your testimony, sir, and have a safe trip back to Montana.

CHAIRMAN BUTTREY: Thank you.

I'd like to now call the first shipper panel as identified as Panel 2 in this hearing.

Speaking will be representatives of the Wheat and Barley Commission, the North Dakota Grain Dealers Association, National Grain and Feed Association, the Fertilizer Institute, the Transportation, Elevator and Grain Merchants Association, and Ag Processing.

We'd like to welcome our guests today at the Board. And what I'd like to do is, if I could for each panel, we'll hear the testimony of all the witnesses on the panel first.

I'd like to remind all witnesses that we have read all the testimony that has been submitted. Therefore, each witness should summarize their presentation and emphasize the main points that they would like to make. Also stay within the time allotted.

Following the testimony we'll turn to questions by myself and Vice Chairman Mulvey alternating the questions and generally limiting ourselves to five minutes a piece and hopefully not even that much because of the pressing time before us today.

I would appreciate if each one of you would identify yourself for the record when you begin your testimony.

And let's begin from my left and proceed across the panel to my right. And our first witness may proceed.

MR. WILKEY: Chairman Buttrey and Vice Chairman Mulvey, good morning. My name is Eric Wilkey. I am Vice President of Arizona Grain. My office is in Casa Grande, Arizona.

I'm also Chairman of the Transportation, Elevator and Grain Merchants Association on whose behalf I appear before you this morning. TEGMA is a North American trade association that brings together global grain companies, domestic shippers and receivers, railroads, port storage houses, inspection agencies and others involved in the shipment of North American grain to customers all over the world.

Taking this mix of the membership provides a unique perspective on grain handling and transportation. And I want to thank you for hosting this hearing.

Our position is TEGMA does not dispute the right of U.S. rail carriers to utilize a fuel surcharge to offset an unexpected rise in fuel costs. However, those surcharges should not become profit centers for rail carriers.

TEGMA comes to this hearing to ask the STB to encourage the uniformity and fairness in the application of fuel surcharges. TEGMA has worked to develop a market-based solution that would allow shippers to better manage their fuel price exposure. At issue is the disparity, the wide disparity of methods used to assess fuel surcharges.

In April 2005, to be proactive on this, TEGMA held a fuel surcharge workshop in Kansas City, Missouri. Every class one railroad was invited. Initially, many accepted. However, anti-trust concerns kept them from attending. We believe the Surface Transportation Board can play an important role in having that discussion amongst those parties.

We as attendees developed a proposal for an over-the-counter instrument to hedge the financial risk associated with changes in fuel prices and fuel price volatility. We have shared this proposal with the industry, with the class one railroads and included it in our testimony in the hearing held last fall on the Staggers Act.

TEGMA believes that if U.S. rail carriers adopted a mileage-based surcharge formula and used a common price index and not to be prescriptive, but some examples might be the 9XCD1 or the national U.S. average on highway diesel fuel price index. We believe an effective economically priced hedge for rail fuel surcharges could be built.

TEGMA encourages the STB to use its position and its power to promote the uniformity among the class one rail carriers for fuel surcharge programs. And to facilitate discussions with the class one railroads and others concerned to avoid the anti-trust question. This way a market-based solution could be developed and applied to this difficult issue.

I know from myself in a company that I work with grain is priced to customers various feed yards and feed mills, export customers'. Not on a one-month basis, which we have some idea of what those fuel surcharges would be one month out, but on a three, a six, twelve month and possibly even longer period. And these fuel surcharges not knowing them ahead of time and not having a way to effectively in a price-efficient way hedge that risk out creates great risk.

Any company such as mine that has taken a bet on what fuel prices would do in the last two years has made a pretty dangerous bet and one that probably wasn't very economically based.

So, therefore, we would thank you for the time to present this thought and this idea. We think it is one part of the fuel surcharge question and a reasonably market-based solution to solving it.

Chairman Buttrey, Vice Chairman Mulvey, we thank you for holding this important hearing.

CHAIRMAN BUTTREY: Thank you.

MR. VOSS: Thank you, Chairman Buttrey and

Vice Chairman Mulvey.

My name is Terry Voss and I'm Senior Vice President of Ag Processing, headquartered in Omaha, Nebraska. We've already submitted a written statement, so I'll be brief with this.

First off I need to mention that I'm a member of the Rail Shipper Transportation Advisory Council for the NTB as well as the National Grain Car Council.

The remarks I make today and in my statement are those of our membership and not of those two committees. In fact, in our meetings you have advised us that we cannot talk about anything active in front of the Board and specifically the fuel surcharge.

Our company is owned by 211 grain cooperatives located throughout the Midwest. We've talked to a lot of them and they've called us and they've encouraged us to participate in this hearing on their behalf.

AGP operates 14 slow grain processing, refining ethanol, soy diesel plants as well as several grain elevators. One hundred percent of our shipments are subject to fuel surcharges. AGP has no problem with fuel surcharges, with the concept as long as it's there to recover the spikes and the swings in the prices. It should be a cost-based mechanism, however.

I'll give you an example. We have a fuel surcharge, we have a freight shipment that moves from the Midwest to California, from Iowa to California. Soy bean meal. Railroad car rates $3,975 a car. The private car rate is $438 less or $3,537 a car. The reason that is is the railroad nets that out. They normally pay a mileage allowance for furnishing the car. This car they just netted out and we get the reduction of the mileage to the freight rate.

The issue is that $438 difference in the freight rate is also in the fuel surcharge. A 13-1/2 percent fuel surcharge in May and 15 percent in June, we paid $59 a car more on a railroad-owned car than we do on an AGP car. It's the same exact car, same exact weight, same exact product, same origin, same destination and literally are hooked together in the same train. That is inequitable. That's not a fuel cost that should be passed through.

There's no cost difference in my mind in pulling a railroad owned car versus an APG car. I'll disagree with Eric here in a little bit. We're a member of TEGMA and we visited earlier. AGP does not support the retail fuel highway diesel or the West Texas Intermediate Crude Index for a benchmark.

Railroads don't operate on a highway and they don't pay the fuel tax that the trucks do, which are included in the highway diesel tax. We feel the railroad should use a wholesale price that are paid by industrial customers which is available by the Department of Energy on their website. This price excludes the taxes that are levied by each state. This year alone, for example, six states have already increased the fuel tax that they charge. This artificially in my opinion inflates the benchmark where the railroads bench off of. This number, however, is still part of the calculation when they figure their fuel surcharges.

We don't believe the freight surcharge as applied to the freight rate has any relationship to the fuel cost itself. Fuel surcharges have a very significant impact on our company and our ability to market. As our costs increase, our availability to compete decreases. In fact, today we are losing soy business to South America and Brazil.

BNSF came out with the mileage-based fuel surcharge as the governor said earlier. We support that concept. I think they're on track. No pun intended, but I think they are a little bit wrong in their methodology on how they figure the cents per mile allowance.

I also question why coal is $.22 per mile and agricultural products are 50 percent more or $.33 per mile on a fuel surcharge from that.

Carriers do provide you with R1 reports annually and we've looked at those and we had a consultant look at those and it seems like the fuel surcharges are quite high. We expect fuel surcharges to continue and they should be, I guess, as long as they're tied to the recovery of the fuel shipment cost itself in effect when the rate was established. It would be our preference to be stated in miles, which can easily be achieved. All of us have that in those computers. If the railroads don't adopt this soon voluntarily, we would ask that the Board do something and maybe in another proceeding.

Thank you.

CHAIRMAN BUTTREY: Thank you, sir.

MR. MACK: Good morning, Chairman Buttery, Vice Chairman Mulvey.

My name is Dan Mack. I'm Vice President of Transportation for Seed, Incorporated, located in St. Paul, Minnesota.

I'm here today, however, representing the National Grain and Feed Association for which I serve as Chairman of the Rail Shipper and Receiver Committee.

We commend the STB for conducting this hearing. As you aware, NGFA and with the Fertilizer Institute and Forest Products Association of Canada sponsored a study of fuel surcharges in late 2004 and engaged in discussions with six of the largest North American class one carriers in 2005 regarding our collective concerns of the fuel surcharges.

Our interest and first work directly with carriers was partly at the urging of the STB for railroads and their customers to seek private sector solutions. Some carriers were responsible for this private sector initiative and made modifications in 2005 and 2006. Other carriers have resisted refinements that might improve formula accuracy and equity.

More than one year has elapsed since we began those discussions. Therefore, this hearing is timely. And as an outcome of this proceeding, the NST raised the issue of whether rail fuel surcharges are part of the rail rate or could be considered an unreasonable practice. In NGFA's view, it would be a misuse of the ICCTA to require a shipper with a complaint regarding the structure of fuel surcharges to bring a formal rail rate challenge at a potential cost of several million dollars.

The railroads have stated their fuel surcharges are necessary to recover unanticipated increases in fuel costs. NGFA does not disagree. However, if fuel surcharges are being used for some other purpose, the railroads have been misleading their customers. A fuel surcharge has never been necessary and would not be necessary today except to recover fuel costs that are not anticipated at the time the freight rate is established. If the railroad uses fuel surcharges for some other purpose, it is an unreasonable practice.

Fuel surcharges have been described by carriers as hardship measures designed to recover unanticipated costs. As such, they do not fit into the mold of the type of railroad rates intended to be subject to only those with regulatory oversight applicable to market-oriented rates.

NGFA believes that the Board not only has authority under its unreasonable practice jurisdiction to require carriers to be more transparent with fuel surcharge practices, but also to regulate the manner in which fuel surcharges are calculated.

I'd like to discuss with you some of our primary concerns regarding fuel surcharges.

First, we agree that railroads have the right to recover unanticipated increases in fuel expenses provided such surcharges are reasonably related to the increase in market fuel expenses that have occurred after the railway freight rates were published. Importantly, the measure of what is reasonable excessive should be applied on a shipment basis and not system-wide for each railroad.

Second, in constructing a reasonable fuel surcharge mechanism, we think it makes business sense for the carrier to exclude hedging gains and losses. Hedging strategies are internal to each business and will vary by carrier.

Some have suggested that fuel hedging mechanisms for shippers might be a part of the solution to the surcharge issues. NGFA doesn't agree with this as a remedy. Over time, taking a zero sum gain it can act direct for assessments that may be considered excessive. Hedging mechanisms are the risk of the individual carriers and their individual choice. The losses and gains shouldn't fall to their own benefit.

Thirdly, most railroads assess fuel surcharges on a percentage of the base rate. This fact alone creates immediate concern regarding the reasonableness of surcharges on individual shipments. This because rail rates are not in general highly correlated with the fuel expense of individual movements. Rather, they are an outgrowth of the differential pricing.

NGFA and many other shipper businesses offer examples of surcharge cost discrimination that occurs among shippers because the surcharges are applied to rates.

Four, some carriers take the position that as long as the full collected surcharge revenues do not exceed the full increase in fuel costs compared with a base period, the fact that some individual shippers are being assessed successfully should not be an issue. We have a fundamental disagreement with this stance. The practice that transfers cost burdens from one customer to another is unreasonable. An unreasonable practice that adversely affects only a portion of the railroad's customers is still an unreasonable practice.

In our view, it is not justifiable for a carrier to charge a portion of his customers excess fuel surcharges to compensate for commercial decision to not assess the charges on other customers.

Fifth, rail fuel surcharges have caused a great deal of skepticism on the rail customers. A portion of this skepticism is driven by a lack of transparency by the carriers in reporting information.

In NGFA's written submission we provide some estimates of the average per car or compensation costs of the current surcharges. It should be noted we did make several assumptions in deriving these estimates.

We offer specific recommendations on the additional data needed by rail customers to assess whether the surcharges they paid initially are reasonably related to fuel cost increases.

The additional data should be provided voluntarily by carriers. If railroads expect their customers to pass down increased fuel costs, then they should be more than willing to provide appropriate documentation to demonstrate they are only assessing charges that recover those costs and nothing more.

However, to ensure uniform compliance and ensure data comparability, we urge the STB to require the reporting of this information by the carriers.

Our analysis indicates that comparing the fourth quarter 2005 to a base fuel cost period in the fourth quarter of 2001, the average shipper paying the full surcharges is being overcharged on all six major class one carriers. The range in over compensation of fuel costs increased its range from $10 to over $80 per car under what we view to be very conservative assumptions.

Keep in mind that this is only for the average shipper. Those shippers that already paid the highest rates are likely to be overcharged more.

To explain why we believe overcharges are occurring. First, there's a fundamental bias in some of the carriers' formulas. What we mean is that as the price of oil and diesel fuel rise, the formula and calculation provide more surcharge revenue than can be justified by the true cost impacts on the carrier's operation.

Another factor that affects most of the

carriers is a formula so designed in an area when rail rates were much lower than today. Applying the same formula in today's higher rate environment creates a double dipping effect caused by the interaction of higher fuel surcharges percentages applied to a substantially higher rate.

Our point is that many of the factors that affect fuel surcharge assessments have changed. Those that have changed are rail rates, the relationship between diesel oil and crude oil prices, fuel efficiency and lastly the overall level of fuel prices. Because of these changes, we recommend that each of the carriers undertake a serious review of the accuracy and equity of current fuel surcharge formulas and make necessary adjustments.

In this review, we also urge the carriers to consider alternative means of assessing surcharges that are truly more related to fuel cost increases of individual shipments. Specifically, we would recommend the following: First, the carrier should seriously consider surcharge systems that are not applied to the freight rate. Because of the equity issues caused by differential pricing and because of re-escalations over time, possibly per car charges and some adjustment to mileage ranges on an individual basis should be evaluated.

Secondly, to assess fuel surcharges only to the appropriate extent necessary to allow carriers to recover fuel cost increases unknown at the time the freight rate was published.

Third, if surcharge formulas continue to be applied to rates, railroads need to undertake more frequent review and adjustments to formulas to avoid the double dipping of multiplying higher fuel surcharges to a higher rate.

Lastly, if surcharge formulas continue to be applied to rates, raise the base fuel price at which surcharges begin. This so as to lower the surcharge percentage. This will tend to reduce inequities in applying the surcharge percentage to the different rate structures.

If the carriers choose to not make voluntary corrections to the programs within a reasonable time frame, we urge the STB to issue guidelines to primary carriers on an accepted methodology for assessing the fuel surcharges. National Grain and Feed appreciates the opportunity to speak before you today.

CHAIRMAN BUTTREY: Thank you very much.

Mr. Strege.

MR. STREGE: Thank you. Good morning, Mr. Chairman and Vice Chairman, staff and all of the testifiers and all those in the room.

My name is Steve Strege. I'm here on behalf of the North Dakota Grain Dealers Association and we are a trade association of country grain elevators in North Dakota and a few in bordering states who receive grain for farmers, clean it, segregate it by qualities and ship it to both domestic users and export ports.

Fuel surcharges raise overall transportation costs. This impacts grain elevators and the price they can pay the farmers for their grain.

The unpredictability of fuel surcharges creates a problem for grain elevators offering forward price contracts to farmers. Rural communities are affected when less is received for agricultural production in the area. Increased costs can detract from the competitiveness of our grain on the world market. Fuel surcharges have many ripple effects.

We too thank you for holding this hearing and for focusing on the right question, whether railroad fuel surcharges actually reflect the increased fuel cost on the shipment being assessed.

CHAIRMAN BUTTREY: Mr. Strege, excuse me just a moment.

Is his microphone on? They are having trouble hearing in the back. I'm not sure that all the people in the room can hear and I was a little concerned about that. You may have fans back at home that want to hear what you have to say.

MR. STREGE: Oh, they're cheering right now, I'm sure. They probably cheer more for Dan though.

We aren't here today to talk about whether railroads collect enough in total fuel surcharges system-wide to cover their increased fuel costs system-wide. At the other extreme, I don't think anyone is asking that railroads calculate a unique surcharge for each shipment, although they may have the data to do just that.

Our primary message to you today is that railroad fuel surcharges be reasonably cost-based. You will hear much evidence that they aren't.

Railroads unilaterally impose these charges. Rail customers are forced to pay because they have no effective alternative means of transportation. The broad interest in this hearing testified to the concern and the economic pain suffered.

I read several of the shipper statements. Common themes include evidence of over charges and the desire for cost-based surcharges. We think it is time for the STB to take a closer look and to effect more positive change. It's time for railroads to get surcharges in line with actual increased costs.

Because BNSF is the larger carrier in my region and because it had the higher fuel surcharge over most of the past couple years, it has drawn the most attention in the Northern Plains.

Early last year BNSF said it was collecting fuel surcharges on only half of its revenue base to the extent some payers were being overcharged to make up for those who were not paying. This is robbing shipper Peter to pay expenses generated by shipper Paul. This is an unreasonable practice on any railroad.

According to a brokerage house analysis quoted in our written submission, some railroads were using fuel surcharges to pad their bottom lines. Railroad earnings were said to face a head wind or drag if fuel prices declined. We believe assessing more fuel surcharge than actual increased fuel expense is an unreasonable practice.

Gentlemen, you have read our written testimony including the spreadsheet about increased fuel cost versus fuel surcharge on BNSF. It view fuel costs from mid-2002 when BNSF last had zero surcharge and compared that to fourth quarter 2004. To its credit, the BNSF has changed its method of calculation. But on a specific movement basis, our experience and data point out the inaccuracy of using a rate-based method of calculation which all the railroads except the BNSF still do. So, I would like to highlight a few things from that experience.

In one case, the fuel surcharge on a train load was over $41,000 when the actual increased cost was less than $14,000. Surcharges were up six or seven times the increased fuel cost.

Surcharges sometimes exceeded total fuel cost. Surcharges on different grains from the same origin to the same destination varied by 50 percent. These are unreasonable practices.

In some case, surcharges were less for longer hauls than for shorter hauls of the same weight or much the same route. In one example a haul nearly 1,300 miles paid 17 percent more for a car a mile than a haul of almost 1,750 miles. We think that defies common sense and is an unreasonable practice.

We compliment BNSF Railway for making the change to a mileage-based surcharge on grain and coal this past January 1. This is a step in the right direction. It has at least partially eliminated some of the distortion just mentioned. We think other railroads should follow BNSF's lead and improve upon it. It seems common sense that mileage must be a component of a reasonably cost-based fuel surcharge.

Driving the family car or a railroad locomotive 1,000 miles consumes more fuel than driving it 500 miles.

Another component to a mileage-based surcharge is the per car mile charge. We wonder how BNSF arrived at $.33 per mile for grain this month but only $.22 per miles on coal. This assumes to say that coal should be increased but rail customer confidence is shaken by a process that yields such variable results.

The railroads feed crude oil price or highway diesel price in one end of a black box and out the other end on their fuel surcharge. We need transparency in this process so rail customers know they are paying what is necessary and no more.

While we applaud the BNSF lead in switching to mileage based, mileage based is not an end-all. It must be accompanied by an accurate per mile charge. I am told that short lines and regional railroads operating in my state get none of the fuel surcharge collected by the major carriers. Clearly these smaller railroads have additional fuel expense. The welfare of these smaller railroads in this regard is of interest to us and should be to the Board.

Railroad fuel surcharges are a big deal by anyone's measure. According to its own financial reports, over 57 percent of BN's total fuel cost in 2005 was covered by a fuel surcharge. It has been over two years, about two years, since fuel surcharges took off in a steady upward climb. With the recent run up in crude oil prices, fuel surcharges on all railroads will become even more of an issue. Some of that may be justifiable. Some of probably not. It is time for the Board to exert its influence and authority on the railroads on behalf of rail customers to inject equity into the situation.

Our association believes that several principles should apply to railroad fuel surcharges. Our short list and what Mr. Mack has said, assessing fuel surcharges is justified only if the railroad is not recovering its increased fuel cost through some other mechanism such as rate increases or the rail cost adjustment factor.

Surcharges should cover the increased cost of fuel on the shipments to which they are applying. They should be cost-based. Basing a fuel charge on a rate is not an accurate reflection of true increased cost and penalizes captive shippers more than others. The rail customers who pay fuel surcharges should pay for only their own use. They shouldn't have to make up the shortfall for rail customers who don't pay.

If surcharges are necessary, then it seems like short lines and regional railroads should get their fair share. Rail customers are entitled to know how their fuel surcharges are being calculated and if they are equitable.

Open the black box.

One of our members contacted me last week with the thought that where fuel surcharges have been very excessive there should be a rebate back to the payers. This is something the STB might want to consider.

Thank you, Mr. Chairman and Vice Chairman Mulvey for the opportunity and I will try to answer any questions that you might have.

CHAIRMAN BUTTREY: Thank you, Mr. Strege.

Mr. Whiteside.

MR. WHITESIDE: Mr. Chairman and Vice President Mulvey, thank you and the staff. I appreciate the opportunity here to address you.

I represent a number of wheat commissions and barley commissions including Montana Wheat and Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley, Idaho Wheat, Nebraska Wheat Board, the Oklahoma Wheat, South Dakota Wheat Commission, the Texas Wheat Producers as well as the National Association of Wheat Growers.

The reason I go through the list is that I'm going to cover a very large area and the concerns are virtually the same.

I totaled up the number of minutes today and it's going to be about 320 minutes so I'm going to go very quickly.

We have presented a written statement and

I just want to cover a couple of points because I'm honored to be on this panel. This is like a panel of friends. We've worked together most of us on a number of occasions.

The Wheat Commission or the Wheat and Barley Producers recognize that the railroads need to recover unanticipated increases in fuel. We have no quarrel with the concept. We think if the methodology is fair and equitable to all rail customers and collections are not exceeding recovery of charges for changes in fuel, then we think it's a reasonable practice.

Fuel surcharges need to be cost-based. You've heard all down the panel. And they need to be based upon the fuel expended for individual movements.

The current process has four basic claws. The current rail fuel surcharge program is collecting from less than the full universe of customers. You've heard that coming down the line. Rail customers less than the full universe that are being assessed fuel surcharges are being charged surcharges that are greater than the incremental increase in the fuel cost incurred by the railroads for that particular moment.

Number three, some of the rail customers are being charged fuel surcharges based upon rate level and some are being charged upon mileage formulas which creates a differing level of fuel surcharge burdens on different rail customers.

And number four, the methodologies for attaining the fuel surcharge information leads to uncertainty in the calculating of the correct fuel surcharge assessment. What Mr. Strege calls the black box.

Our calculations, we all have them and have shown that the fuel surcharge, fuel cost ratios of using fourth quarter in `05 run about 25 to 40 percent higher than actual costs. Clearly, we're being assessed incremental fuel costs that lead us to the conclusion that there is an over collection process going on when they're collecting 40 percent more in fuel surcharge than the entire allocated fuel cost of the movement.

We think any future methodology prescribed by this Board must be readily ascertainable, fairly applied and predictable. You'll have some witnesses later in the day that will talk about transparency all day.

I think it's important that we recognize that the Board has in our opinion ample authorities and their authority is broad enough to examine and correct this fuel surcharge program.

Railroads have tried to sell their fuel surcharge programs as necessary to recover unanticipated increases in fuel cost for the shipments to which the surcharges are applied. Clearly, as Dan Mack has said, if the fuel surcharges are being used for over collection or additional profit, the railroads probably have been misleading their customers.

When a freight rate is established it has a built-in fuel cost. A fuel surcharge is supposed to collect that over and above what's in the rate. And it's what was not anticipated at the time that the freight rate was published.

To the extent that the railroad uses a fuel surcharge for some purpose other than that, it becomes an additional profit center and that clearly is an unreasonable practice.

Summary. The Wheat and Barley Commission want to thank the Board for the opportunity to present these comments to the Board.

The opportunity to present comments on this issue provides a needed forum to examine the legitimacy of the fuel surcharge assessment as being practiced by the nation's railroads. We who shoulder the burden of the assessment look forward to the future Board action on this issue through the promulgation of rules that will bring fairness to the fuel surcharge assessment process.

We also hope as the Governor just spoke of that this hearing signifies a dawning of a new era of this Board that will continue through hearing processes like these to shine its light on rail practice and customer rail customer issues and will be the source of promulgated change.

And I thank you.

CHAIRMAN BUTTREY: Thank you, sir.

MS. GILLIES: Chairman Buttrey, Vice

Chairman Mulvey. My name is Judy Gillies. I'm the Director of Transportation for the J.R. Simplot Company Ag Business Group. We are headquartered in Idaho where the fishing is great, by the way, Chairman Buttrey.

The Ag Business Group has been plotted the Western based manufacture of agriculture fertilizers. These fertilizers are distributed domestically to growers for use on crops such as gains, rice, potatoes, vegetables and fruit.

Simplot Company is also a member the Fertilizer Institute or TFI. TFI is the national trade association for the fertilizer industry which represents fertilizer producers, distributors, retail agricultural dealerships, equipment suppliers, engineering firms, distributors, retail agriculture dealerships, engineering firms, importers and other companies involved in agriculture.

Many TFI members use rail transportation and have a strong interest in the fuel surcharge methodologies applied by the rail industry. Fuel surcharges if administered properly are an appropriate means for railroads to recover charges with today's highly volatile fuel costs. Shippers recognize the importance of financially strong railroads and the need for railroads to recover extraordinary fuel costs. However, TFI members are concerned that the fuel surcharge methodologies employed by class one railroads are over-recovering the fuel costs.

TFI co-sponsored a rail fuel surcharge study with the National Industrial Transportation League, National Grain and Feed Association, and other organizations in the year 2004. The result of that study substantiates this concern.

While there are numerous problems with the current fuel surcharge methodologies used by the class one railroads three problems stand out.

One is that the fuel surcharges are not based on actual cost. All but one class one railroad assesses a fuel surcharge based on a percent of the transportation rate of each move.

If fertilizer rates are a commodity market- based rather than mileage-based rate due to the differential pricing of rail transportation rates, commodities assessed higher rates must pay more in fuel surcharges than commodities assessed a lower rate. This is so even when the cost of fuel is the same.

A second problem with the current fuel surcharge methodology is the lack of transparency. Shippers find it difficult to determine the cost of fuel for a particular move. It's equally difficult to determine if the shipper is paying too much under the fuel surcharge methodology program today.

The third problem TFI is concerned with is that there is no measure to verify the extent of over-recovery by the class one railroad. It is TFI's understanding that some shippers do not pay fuel surcharges due to exclusions in current contracts. Railroads should not assess higher fuel surcharges to shippers not protected by current exclusion clauses to recover the fuel costs of shippers with the exclusion.

As previously mentioned, rail rates for fertilizer are market-based. Factored into these rates is the cost of steel, labor and fuel. Fuel surcharges are calculated as a percentage of that rate which itself already contains a fuel component.

Fuel surcharge assessments are charged monthly. This swing in rail rates makes planning and pricing difficult for each fertilizer season.

For example, if fuel surcharge changes from 10 percent to 13 percent that difference on a $45 per ton rate is $1.35 a ton. When multiplied by the millions of tens of fertilizer shipped on the railroads each year, the impact to our industry is significant.

Passing on the fuel surcharges to America's farmers is a difficult, if not impossible task. Farmers use fertilizer, plant nutrients and micro nutrients to grow the grain, corn, potatoes, vegetables, fruit and other products.

Because of the ever increasing cost pressures upon the farmers, they are very concerned about their input costs and often simply cannot afford to pay the higher transportation rates. Thus, it is the manufacturers of these important components of our agricultural economy that must cover the fuel surcharge cost.

Again, TFI and shippers in general appreciate the need for the rail carriers to recover the incremental fuel costs. However, we request that the methodologies used to assess fuel surcharges be based upon the cost of fuel used for a particular move. Additionally, we ask the Board to require full disclosure of fuel costs to the shippers.

Thank you for your consideration in this most important matter.

CHAIRMAN BUTTREY: Thank you very much for all your comments this morning. And we appreciate you being mindful of our time schedule.

I'd like to change the order just a little bit if we could and ask the Vice Chairman if he has any questions at this time. Normally the Chairman goes first, but I'm going to offer that to the Vice Chairman.

VICE CHAIRMAN MULVEY: Thank you, Chairman Buttrey. I'll start off with a comment to Mr. Wilkey.

I found your proposal for an over-the-counter instrument that would allow shippers to hedge the financial risk associated with fuel increases commendable. It's one thing to complain about the practices of railroads but quite another thing to develop a market-based solution to the problem for yourself.

And while we have a mountain of testimony complaining about practices, yours is one of the few that came up with a concrete resolution or a specific approach to the problem. So, I thank you for that.

A couple of people mentioned the difference between the rate for grain and the rate for coal by BNSF even though it's mileage based. And that the grain rate is $.33 a car mile and the coal rate $.22 a car mile.

Could that be attributed to differences in density or the differences in the terrain that grain and coal normally travel over?

Mr. Voss, you mentioned it.

MR. VOSS: I don't know exactly how they figure it. Basically, if you run a hopper train of grain or soy bean meal or something like that, you got 286,000 pounds gross on the rail. You're going to have the same thing in coal. So, I think if you're pulling 100-car train of coal or a 100-car train of grain, I don't know that it makes a lot of difference as far as weight pull.

Co-efficient drag, I don't know. I'm not an engineer. I don't know how that works, but the train, I don't know. I don't know that there would a 50 percent difference in terrain.

VICE CHAIRMAN MULVEY: 50 percent is giving them a lot.

MR. VOSS: It does to me.

VICE CHAIRMAN MULVEY: You also mentioned--

MR. STREGE: I think Terry hit it right on the nose that the weight is the same generally or pretty close to the same and the coal cars are aluminum and so the return trip would be lighter, although the gross weight of the shipment would be approximately the same.

A terrain might vary, but any railroad movement is going to encounter some hills and valleys and some flat plains. And as you said, Mr. Mulvey, 50 percent difference is quite a bit. We'd be delighted if we could, you know, just drop down to the coal rate.

VICE CHAIRMAN MULVEY: Mr. Voss, you mentioned you polled your membership in your testimony. I was wondering if you and your members would be amenable to sharing in more detail information that came out of that survey?

MR. VOSS: I would submit it. I don't have it available. I mean, I've got some notes available, but I would submit it for the record if you want it.

VICE CHAIRMAN MULVEY: Thank you very much. I appreciate that.

MR. VOSS: Do you want it for the record?

VICE CHAIRMAN MULVEY: Yes, please.

MR. VOSS: Okay.

VICE CHAIRMAN MULVEY: Thank you.

I have another question.

CHAIRMAN BUTTREY: Go ahead.

VICE CHAIRMAN MULVEY: Okay.

Mr. Mack, your association urges the STB to issue guidelines and parameters to carriers on certain methodologies with assessing the surcharges.

But does the Board really have the expertise in this area? Should the STB give some guidance as to what is reasonable in general terms, by stating, for example, that surcharges should bear some direct relationship to the consumption of fuel. Or would you have the Board design the entire programs, which I'm not sure that we can do?

MR. MACK: I think that the way you would do that obviously and some of the burden would be the Board. Some of the burden would be on the rail industry, shipper, vendor should come together and determine what is an equitable and logical approach.

Obviously, the authority lies in your side--

VICE CHAIRMAN MULVEY: You said that you expected that the benefits from hedging should go to the carriers. They take the risks and, therefore, they should get the benefit or pay the costs if they hedge wrong. But that's not widely agreed upon by other members of the shipping community.

Does anybody have differences as to how hedging should be treated? Should we take into account hedging in determining what a fair fuel surcharge is? Or should we agree and say that the railroads are taking the risk and they should benefit or not depending upon what happens?

MR. MACK: I can give a perspective.

Our perspective is simply that the risk assessment is entirely up to the railroads whether they choose to hedge or not. Essentially, a hedge is locking in a price. It's not necessarily locking in a better price derived at a later date or a worse price. It's simply deciding to lock in a price.

If there's a gain from that hedge, that should be the reward to the carrier for taking that risk. If there's a loss to that hedge or in other words they could apply for fuel at a later date at a cheaper price, but they'd made a decision to hedge, that's also their burden of error.

Our perspective from the shipper community is that we're not asking for a refund nor do we want to make an additional payment to cover any losses that may occurred from a decision to hedge.

VICE CHAIRMAN MULVEY: Some have suggested that hedging should be taken into account in deciding whether or not how much the rates should increase if the railroads had hedged the price the fuel.

Anyone want to comment?

MR. VOSS: I agree with Dan. You know, if they want to hedge, and put the money in their pocket. Fine. You know, they're going to be upside down sometime on it. And they're going to have a lot of systems and we don't want to participate in those.

MR. WHITESIDE: I guess I would agree with Also, Mr. Mulvey. The amazing thing is that the way it works right now is, we've talked to the boroughs and they've said well the hedging should be ours, but the losses should be yours. And that's not fair either. So, I think divorcing both of them probably makes a lot of sense.

CHAIRMAN BUTTREY: We've heard anecdotal information and your testimony to the proposition that there may be other customers, rail customers, other than contract customers who are not paying fuel surcharges for one reason or another.

I don't know whether any of you have

information or evidence of that practice being prevalent in the industry or not. But we keep hearing that over and over again that the contract carriers that have these provisions in the contracts that do not allow escalation clauses or fuel surcharges, any extra charges that can be placed top of the rate that's in the contract being prohibited.

Is it your understanding or do you believe that there are situations out there where there are certain customers who are getting preferential treatment by carriers who are not under contract for one reason or another?

MR. STREGE: Mr. Chairman, I could address that perhaps.

I submitted a letter with my written comments from the Burlington Northern Sante Fe that a year ago they were collecting from only 50 percent of their revenue base. I don't know if the other people were all contract or not. That was not said, but at that point it was only half. It is a serious problem because if you're trying to make up 100 percent from 50 percent, well, then you're going to have to over charge them.

CHAIRMAN BUTTREY: Is anyone suggesting that there is some mechanism for getting to that issue and how you would get to that or solve that problem by going after the contract situation or the contract has concluded that no fuel charges can be assessed? I mean,there doesn't seem to be anybody who is suggesting that there is some way to do that.

MR. STREGE: Mr. Chairman, if the railroad agreed with these shippers that there would not be an escalation clause for a fuel surcharge, I guess they should be stuck with it. But they should not be allowed to collect the shortfall from somebody else.

CHAIRMAN BUTTREY: The data that has been used to support the argument or support the facts about the difference between the charges of grain and coal interests me. I was wondering if you could tell me if some effort has been made in the collection of that data and the presentation of that data, to show the difference between fuel surcharges for coal and grain. Is there some information you might be able to shed on that? Anyone on the panel?

MR. VOSS: I'll just throw in a thought.

If the fuel surcharge is in the contract, I don't think they would publish it on the website every month. I think it would be hidden in the contract or in a contractual agreement between the shipper and the railroad.

MR. WHITESIDE: Our experience has been with our clients is that up until about 1999/2000, there were contracts that were being made by the railroads that had no cost escalation in them for fuel. Right after that, we starting seeing RCAF-- well, before that a small percentage of RCAF, then the full RCAF was being applied in the contracts after that. And then generally the last couple of years they being ALF-2 plus fuel.

So, what we're seeing is that as those contracts that were cut back in the late `90s are coming due, they're going to be subject to at least ALF-2s probably in fuel. So, that catch-up will occur at some point, if you're following what I'm saying.

But I think the recognition is that in 1999 no one ever thought about fuel as being something that would just skyrocket. And so they weren't even building them into a lot of the contracts that I've been associated with.

MR. VOSS: Our company has not been successful at all in renewing any of our contracts without the fuel in it. So, now all of our contracts are subject to fuel. At one time, not all of them were. And that may be what the railroads are unwinding and I'm going to assume that as they renew these contracts, they're going to treat those the same as they did us and make them subject to fuel.

MR. MACK: Chairman Buttrey, you asked a question earlier, if I may, about are we seeing any fuel surcharge or a need for anything but perhaps a contract that was written with a fuel surcharge? To my knowledge, I have not seen that.

MR. WHITESIDE: We have heard evidence too, some discussion about on the mile-based from the higher mileage areas that one of the railroads is looking at a block mileage to cover a whole area instead of applying individual mileages.

Again, the shorter mileage people probably end up suffering in that kind of an environment.

CHAIRMAN BUTTREY: Do any of you pay fuel charges based on actual railroad mileage or is it figured on some other basis like taking out the old Rand-McNally map and measuring it or something?

MR. VOSS: All the mileage on Burlington Northern SF is real mileage.

MR. WHITESIDE: I talked a little bit about in my statement about the transition trauma that was associated a little bit with that. I don't blame the railroad because it was trying to come up with a new methodology. But it became very complicated for awhile until finally settled on rail miles. That's in my statement.

So, if we ever come up with some methodology, it should be very clear and transparent.

CHAIRMAN BUTTREY: Is there only one railroad that's using the rail miles or are other people using different types of indices?

MR. MACK: to my knowledge, BNSF is the only one. And it applies on BNSF direct only, not on--

What I'm saying on a lot of it they're probably applying on coal and it applies on grain. Other commodities, I believe, for the most part are still a percentage of the freight rate for the freight bill.

VICE CHAIRMAN MULVEY: You mentioned mileage-based surcharge being fairer than rate- based surcharges. If you could design the system to replace the current rate-based surcharges, would the BNSF system be the one you would choose? Or could you envision some other kind of justice in that system or other system that might be fairer?

Everyone seems to agree that we need to cover the cost of fuel to the extent possible.

Does anybody have a suggestion for a more optimal system than the one we have now or the one that BNSF has proposed or is using?

MR. VOSS: I'm not saying the BNSF system is optimal. It is a good system. I think it's just priced wrong. I think the BN system is a good model as long as it's cost-based and the miles charged for mile reflects the cost base.

MR. WHITESIDE: I think I agree with Terry. I think that that's a good start. The real issue is, if it's over collecting, if it's collecting more than the total fuel of the whole movement and just the incremental, then the system is still awry a little bit. It needs some adjustment.

MR. STREGE: I would say that mileage has to be a part of the equation. I think it would be obvious.

Now, the other factors that would go into it, wheat probably one. Maybe there is something about the aerodynamics of train movement and I don't want to make it too complicated. You don't want to have railroads assessing a unique fuel surcharge on each movement, but those are some of the factors that we know and miles has to be one of them. And it's a matter of getting that multiplier, that per mile charge correct and letting the shippers know how they arrived at that.

Open the black box so people can see what's going on so that we can be assured that it is recovering fuel costs--increased fuel cost only and not being used for some other means or other goal.

VICE CHAIRMAN MULVEY: Would it be worth it to help assessing such a charge on a merchandise train rather than a unit train of coal or grain? It would be more difficult to hustle out all the individual commodities and all the individual grains on a merchandise train and assessing a charge for each one of those.

MR. VOSS: I'll say day to day it applies on all the ag products whether it's soy bean oil or ethanol or whatever it might be. Single carloads that run in manifest trains today.

All agricultural products are subject to that mileage already. So, I think that model may be in place.

MR. MACK: I also want to make a comment, I guess, on the mileage per car, if I may. And I think it's more conducive --there's more greater collection of cost. It should be noted though that -- is a little more burdensome on a rate base so that's some disadvantages.

And also certainly in the transition

period when you shift from a percentage to miles, there are some market distortions that you incur that do change the economics of modern values from one market to another.

CHAIRMAN BUTTREY: I have to get this on the record. There seems to be agreement on this panel at least. There may not be on other panels but certainly on this panel that some type of nationwide indexing system will be preferable to what we have now.

Is that an accurate statement and if it's not, I'd like to know why it's not?

MR. VOSS: Yes. It is.

CHAIRMAN BUTTREY: It is accurate on this panel.

We want to thank you very much for coming today. We appreciate your testimony. It will go on the record obviously and we'll get prepared for the next panel.

I'd like to call the second shipper panel identified as Panel 2B in the Notice of Hearing.

Speaking will be representatives of the

alliance of Automobile Manufacturers, Daimler Chrysler, Ameren Energy Fuels and Services, Western Coal Traffic League, Entergy Corporation and the AES Corporation.

Again, Vice Chairman Mulvey and I will hold our questions for the panel until all have testified. I would appreciate again if each speaker would identify yourself for the record at the outset of your comments and we'll continue to proceed with the witnesses from left to right.

It's also apparent that there are some witnesses who are appearing here who are wearing a little bit different hats than they sometimes do. We'd like to have for the record if you're representing someone other than what we have here. We'd certainly like to know that for the record.

Do we have enough chairs?

I'd like to encourage all of you to speak as close to the microphone as you can to accommodate people who are trying to listen in the audience and also people who are trying to listen over the Internet.

We'll start from my left to my right whenever we're ready on the PowerPoint.

MR. PFOHL: I'll get started while they're loading the Power Point.

CHAIRMAN BUTTREY: Please proceed.

MR. PFOHL: Chairman Buttrey, Vice Chairman Mulvey, my name is Peter Pfohl and I'm with the law firm of Slover and Loftis. Accompanying me here today is Tom Crowley, President of L.E. Peabody and Associates, an economic consulting firm.

Together we're here today on behalf of the Western Coal Traffic League, an association of 18 electric utilities that collectively move approximately 140 million tons of coal by rail on an annual basis.

Mr. Crowley and I appear today to summarize our written submission and to answer your questions.

I'll start and then I'll turn to Mr. Crowley who will summarize the economic analysis he conducted for the League.

The Board has called this hearing to

discuss the question of whether the carriers' programs are being used only to recover the increased costs of fuel for the particular movement to which the surcharge is applied.

The answer to this question is clearly no. As Mr. Crowley will attest to in a few minutes, for an average western coal haul, both UP and BN collect significantly more in fuel surcharges in the chart than the change in their fuel costs to the tune of between $.53 per ton and $.95 per ton for an average coal move.

Coal League members are well aware of the recent run up in gas prices and they don't generally have an issue with the carriers' attempting to recoup the costs of their services.

Twenty-five years ago the ICC adopted the rail cost adjustment factor index as a mechanism to enable the railroads to adjust their rates to cover changes in their service costs.

As Mr. Crowley will explain, unlike the price data currently relied on by the western carriers in their fuel surcharge programs, the RCAF fuel index closely tracks the carriers' per gallon cost of locomotive diesel fuel.

Well, the carriers apparently have decided to move away from the proven RCAF index by implementing more lucrative fuel surcharge programs that overcompensate them for their incurred fuel costs. And this is on top of the well-publicized general rate increases they have been able to sustain on their coal customers in the last few years. And these programs are indeed lucrative.

Under the western carriers' programs, 22 percent of surcharges have been applied on the line haul rate per ton of coal. UP and BNSF alone collected $2.1 billion in fuel surcharges in 2005. And as applied on a single average western coal haul, surcharges are approximately $30,000.

Under governing precedent, rail carrier surcharge programs have been sparingly permitted in the past. Those programs were authorized to address unexpected and precipitous increases in prices that were verified by the carriers. But they are for a limited period, typically lasting for no longer than one year.

The carriers' current programs fail this test as well. The carriers are not implementing fuel surcharges across the board in all common carrier traffic on a long-term basis.

The carriers will likely argue that they have instituted their programs and come to rationally deal with the fuel price increases. However, under governing precedent, when evaluating the reasonableness of railroad practices, the question to be considered is not whether the practice can be described as rational from the railroads' perspective. But instead whether the practice is reasonable as applied.

The problem with the railroads' programs is that they are not reasonably applied today.

The Board is the only regulatory watchdog that is capable of addressing industry fuel surcharge practices on a consistent basis in a manner throughout the nation and with a view towards balancing the interests involved.

The Coal League submits that the Board has the obligation to ensure that the carriers do not continue to collect any fuel surcharges on movements that do not reasonably track their increases in fuel costs.

The Coal League's analysis verifies that UP and BNSF fuel surcharge programs bear no reasonable relationship to their involved service costs to individual customers. And they should not be allowed to be sustained in their current form. Carriers should instead employ the standard and proven cost recovery mechanism, the RCAF, to recover increased fuel costs on individual movements.

Thank you and I'll now turn to Mr. Crowley to describe his analysis.

MR. CROWLEY: Good morning Chairman Buttrey, Vice Chairman Mulvey.

I was asked to evaluate two issues related to fuel costs. And particularly I was asked to evaluate BNSF and UP.

The chart on the screen summarizes the results of our evaluation of the fuel surcharge program and whether or not it recovers the incremental costs of higher fuel prices.

The matrix on the left is in dollars per ton and way across the bottom we see the two different BNSF fuel surcharges. One is a percentage, which is the first one on the left. The one in the middle is BNSF's mileage fuel surcharge and the right is UP's fuel surcharge.

The analysis that we performed first evaluated the average move for coal. We calculated the average rate for both BN and UP. Then we calculated the average fuel surcharge from the beginning of the fuel surcharge program through 2005. This represents that change in that time period.

We did the same analysis for BNSF's and UP's fuel cost, again using the average characteristics of an average coal train.

The results of our finding first for the cost. The incremental change in the fuel cost experienced by BN as you see on this chart is $.53 a ton. That would be the same for both fuel surcharges.

For the Union Pacific, the change in their fuel costs were $1.02 per ton.

The green line reflects the application of the fuel surcharge for coal for both of these carriers.

For BNSF on a percent basis, the fuel surcharge would generate $1.30 per ton and the difference between those two numbers obviously is the amount that the fuel surcharge over-recovers.

For the mileage fuel surcharge, the fuel surcharge revenue is $1.48 per ton and again considerably greater than the cost or the incremental cost associated with fuel.

For the Union Pacific the numbers are. The fuel surcharge generated $1.58 per ton and the incremental change in fuel cost for Union Pacific resulted in $1.02 per ton.

Now, both of these carriers are over-recovering their fuel costs increases. Their incremental fuel cost increase.

The second page of this exhibit are the numbers and the values and the sources that support the three columns on the previous graph.

The second question I was asked to address is whether or not the fuel index portion of the RCAF accurately tracks the fuel cost changes.

What this chart shows you is the change in the RCAF fuel index. That portion of the total RCAF that is fuel. That would be the blue line. And what we're measuring is the cumulative percent change from one 1/2/04 which is when BN began its fuel surcharge program and tracks it through the end of 2005.

The purple line or the chartreuse line or whatever you want to call that color, represents the change in BNSF's fuel price per gallon. And you can see over the same two time periods that the RCAF fuel index actually increases faster than the change in BNSF's fuel price per gallon.

The next chart is a similar analysis except we have substituted the Union Pacific for the Burlington Northern and moved the beginning of the analysis back to 1/2/03, which is the time period when the Union Pacific began their fuel surcharge program. And you can see a similar result to what we saw on the previous chart.

On a cumulative basis from 1/2/03 through the end of 2005, the RCAF fuel index actually increased faster than the change in UP's fuel price per gallon.

The next chart or the last page are the numbers that support the numbers that were plotted on the previous two graphs.

Thank you.

MR. MOHL: Hello and good morning, Chairman Buttrey and Commission Mulvey.

I would like to thank the Board for taking up the issue of fuel surcharges and allowing me the opportunity to speak with you today.

My name is Bill Mohl. I'm the Vice President of Commercial Operation for Entergy Services, Inc., a subsidiary of Entergy Corporation.

I'm responsible for the procurement of all limited and long-term resources for both fuel and generation for the Entergy operating companies.

The purpose of my testimony today is to highlight Entergy's concerns with the fuel surcharge programs instituted by the nation's railroads. I will not address the Board's authority to review fuel surcharges or issues related to mileage-based surcharges, both of which are sufficiently covered in our written comments.

Entergy Corporation is an integrated energy company engaged primarily in electric power production and retail distribution operations. We own and operate power plants with approximately 30,000 megawatts of electric generating capacity and deliver electricity to 2.7 million utility customers in Arkansas, Louisiana, Mississippi and Texas, as well as numerous wholesale entities.

Our generation fleet includes several coal plants. Most of the coal fueling these plants comes from the Powder River Basin in Wyoming and is shipped to the plants by rail cars.

For example, Entergy's subsidiary, Entergy Gulf States, receives coal shipped from the Powder River Basin pursuant to contracts with BNSF and the Kansas City Southern Railway or KCS.

These and other railroad transportation contracts now impose fuel surcharges upon the buyer.

In order to simplify my testimony today

and relate specific real life experiences with railroad fuel surcharges, I will occasionally refer to the Burlington Northern Sante Fe coal transportation contract for Entergy Gulf States Nelson Plant in Louisiana.

BNSF imposes fuel surcharges under that contract through BNSF's Public Rules Book 6100, item 3380.

I wish to emphasize, however, that Entergy surcharge issues are not limited to Burlington Northern, but apply to all railroads having transportation contracts subject to fuel surcharge tariffs.

Contrary to the claims of some of the railroads, Entergy is not requesting re-regulation of the railroads. As a threshold manner, Entergy does not object to the concept of fuel surcharges, provided that the surcharge is allowable under the contractor tariff, is limited to the purpose of recovering or refunding genuine documented variations in fuel costs from those assumed and built into the transportation rates to which they apply and are transparent and subject to regulatory oversight.

To insure that this prerequisite is met, Entergy recommends that five pass-through principles be applied to any railroad fuel surcharge mechanism. These principles are:

(1) Fuel surcharge mechanisms should be strictly cost-based and should not increase the railroad's profitability to the movement to which they apply.

(2) Fuel surcharge mechanisms should be transparent and subject to the oversight of regulatory authority, in this case, the Board.

(3) Fuel surcharge mechanisms should provide for both positive and negative fuel surcharges to allow railroads to recover significant fuel cost increases, as well as allow customers to recover significant fuel cost decreases, as compared to the fuel costs assumed and built into the rates to which they apply.

In addition, no minimum fuel surcharge should apply.

(4) While we prefer the use of a

railroad's actual cost to calculate fuel surcharges, to the extent an index is used, the index should be determined by the Board with input from shippers and other stakeholders to most accurately track variations in the actual unit costs the railroads pay for fuel.

Lastly, non-fuel costs should be clearly segregated from fuel costs. Cost adjustments based upon indices that include both fuel and non-fuel costs should reflect the relative split between the two and prevent over-recovery.

These five principles are not new to the market. They're based on similar principles which are applicable to Entergy and other utilities that pass through fuel costs for electric generation directly to their customers. For these companies, fuel cost related price adjustments both upward and downward are accomplished through an expedited regulatory process conducted separate and apart from the utility's other cost-related rate adjustments.

Adopting and applying Entergy's proposed principles would help insure that railroads recover their actual fuel costs for rail movement, the stated purpose for fuel surcharges and that their customers are not overcharged for fuel.

Today there are no such assurances. In fact, BNSF's fuel surcharge at Entergy Nelson's plant is expressly not strictly cost-based and allows for the possibility of significant cost over-recovery.

The absence of a cost-driven surcharge is apparent from the way it is calculated. The fuel surcharge is determined by taking a pricing variable and multiplying it by the base rate which includes market components entirely unconnected to the railroad's fuel expense.

For BNSF's fuel surcharge, the variable is established by the index price for on-highway diesel fuel for HDF. The formula provides that if the HDF index price is say between $3.00 and $3.039 over the billing period, the added fuel surcharge for that period is 22-1/2 percent of the base rate.

On its face, a fuel surcharge determined by reference to a base rate incorporating market rates is simply not cost-based.

The effect of this methodology is to

increase incremental fuel surcharges when movements have high market values regardless of the movement's incremental cost to the railroad.

Further, the HDF index itself is not an appropriate measure of a railroad's actual fuel cost. It lacks the necessary nexus to BNSF's actual incremental fuel cost to serve as an appropriate proxy for use in the calculation of the fuel surcharge. The HDF index price is essentially the average retail price paid at truck stops and service stations for diesel fuel. But BNSF is able to buy its fuel in bulk at wholesale, not retail prices, and without certain taxes.

These and other differences introduce a level of unacceptable variability in the fluctuations between the HDF pricing index and BNSF's actual incremental fuel cost.

To illustrate the disconnect between incremental fuel cost recovery and actual fuel cost, consider this. According to BNSF's investor reports, BNSF's average cost for diesel fuel in the third quarter rose by 14.4 percent from 2003 to 2004. In contrast, the average HDF index price over the same period increased by 25.3 percent.

Under BNSF's fuel surcharge, BNSF shippers would have been forced to pay on an incremental basis almost double the increase BNSF actually incurred for its diesel fuel costs.

The structural flaws caused by the failure to have surcharges track actual fuel cost can lead to absurd results. Under the BNSF formula, for instance, fuel costs recovery can increase even when incremental fuel costs have not changed. A hypothetical illustrates this point.

Let's assume a multi-year transportation agreement with the BNSF fuel surcharge and an initial base rate of $10.00 a ton tied to an index adjustment. If at the beginning of the contract term, the fuel surcharge rate is 20 percent of the base rate, the fuel surcharge adder would be $2.00 a ton with an all-in rate of $12.00 a ton.

Now assume that after one year all non-fuel index cost escalate by 5 percent and that fuel costs stay flat. The base rate would bump up to

$10.50 a ton and despite the fact that fuel cost did not rise at all, the fuel surcharge adder at 20 percent of the base rate would increase to $2.10 a ton.

Similarly, instead of staying flat, fuel costs actually dropped after that first year such that the fuel surcharge rate worked out to be 19.5 percent of base rate, the fuel surcharge would be $2.05 a ton. An amount greater than the $2.00 a ton in the first year when fuel costs were actually higher.

It makes no sense for a fuel surcharge to increase in periods of static or falling fuel prices. Yet, that is exactly what may happen under our rail transportation contracts.

Another failing of BNSF's fuel surcharge is that it does not provide for negative adjustments if and when fuel costs fall below a threshold level. Dips in fuel cost accrue exclusively to the railroad's benefit under the current formulation. This one-way treatment of fuel cost has been imposed by railroads and is fundamentally inconsistent with the purpose of the fuel surcharge.

Moreover, BNSF's fuel surcharge mechanism offers no assurance against double-dipping. Indeed it is quite possible that the current cost of fuel or at least a portion of it was already factored into new BNSF base rates and is being recovered from customers separate and apart from the fuel surcharge.

We know that BNSF's fuel surcharge mechanism kicks in when the HDF index price exceeds $1.24 per gallon. Yet, the HDF index price has not been below that level for four years since March of 2002. The current base rates may include a cost that reflects all or some of this rise. Similarly, there's no guarantee that fuel cost increases captured by index adjustments and base rates are backed out of the BNSF fuel surcharge. In fact, we expect the opposite to be true.

Regrettably, we are unable to be more informed about the specifics of fuel cost recovery. This information is in the hands of the railroads. Customers have no ability to review or audit in any meaningful way the recovery of fuel costs in railroad surcharges and base rates to insure they are receiving fair and just treatment. Thus, Board oversight in this area is vital.

And, again, I appreciate the opportunity to be able to present this to you today.

Thank you.

CHAIRMAN BUTTREY: Thank you very much, sir.

MR. WILCOX: Good morning, Chairman Buttrey, Vice Chairman Mulvey.

My name is Thomas Wilcox. I'm with the law firm of Troutman Sanders and I'm here on behalf of the AES Corporation.

CHAIRMAN BUTTREY: You need to get a little closer to the microphone and make sure it's on. That's good.

MR. WILCOX: Again, I'm here on behalf of the AES Corporation. I'm accompanied by Mr. Roger Prescott who is Executive Vice President of Peabody and Associates, just to the extent the Board has technical questions about AES' written submitted. And I'm also accompanied by Mr. Mark Michael, the AES Corporation, who is in the audience today.

My testimony will again summarize the written comments submitted by AES on April 27th in this proceeding.

AES Corporation is a holding company with headquarters in Arlington, Virginia. It is a global power company with subsidiaries throughout the world. AES through its subsidiaries operates 20 electric generating facilities in the United States, 9 of which are coal-fired generating stations located in Oklahoma, New York, Indiana and Connecticut. These facilities burn approximately 12 million tons of coal per year. And it's delivered in a single line as well as joint line service by BNSF Railway Company, Norfolk Southern Railway Company, CSX and the Kansas City Southern as well as short lines in some instances.

BNSF, NS and CSX assess AES fuel surcharges in addition to the base railroad rates. These fuel surcharges have been established in public pricing circulations and tariffs but they apply to the contract service that is supplied by the railroads.

AES echoes, I guess, the consensus we've heard so far and I think you'll continue to hear that the railroads should fully recover the costs of diesel fuel needed to provide service to the AES utilities.

However, as discussed in the written comments in more detail, AES is convinced that the current fuel surcharge as imposed by the class one railroads, although represented as a means to recover spikes in diesel fuel costs, in fact, substantially overcompensate the railroads for their fuel costs, are in fact an increase in the overall rate for transportation.

The fuel surcharges have been imposed in addition to significant base-rated increase as AES' rail transportation contracts have come up for renewal in the past several years. In some cases, the combination of a double digit rate increase in the tariff fuel surcharge mechanism has resulted in the overall cost of transportation in certain facilities increasing 35 percent in the first month of a new contract.

Acceptance of the tariff fuel surcharge is presented on a take it or leave it basis, non-negotiable. All efforts by AES to modify or reduce the impact of the surcharge during contract negotiations were rejected.

First you have to have coal, so the only alternative for AES' plans that are captive through a single railroad was to take service under even higher common carrier rates and pay an even higher fuel surcharge because the fuel surcharge is based on rates. And then incur the considerable costs and significant uncertainty of a coal rate reasonableness case.

Faced with this alternative, AES essentially bit the bullet and has executed new contracts that accept the tariff fuel surcharges.

So, while AES applauds the Board for holding this hearing, AES echoes the comments that you've heard from others already that this proceeding highlights the need for increased competition in the rail industry and for the promulgation of fair rate-setting standards.

Stated another way, the ability of the class one railroads to force AES and other coal shippers to accept tariff fuel surcharges that substantially over-recover the fuel costs for the movement into a new contract, is a strong indication that there is insufficient competition in the rail industry today and insufficient regulatory constraints to prevent individual railroads from abusing their market power.

Again, AES does not object to the railroad serving AES' facilities’ recovering spikes in their fuel cost associated with a particular movement via a surcharge. However, AES believes the Board should establish certain parameters.

First, there should be no fuel surcharge allowed when the rail cost adjustment factor is used to adjust the rate. The Board's predecessor determined long ago that fuel surcharges in addition to the RCAF are inappropriate and a double count of fuel costs.

If the railroads have a question of whether the RCAF is adequately recovering their fuel costs, they are free to ask the Board to modify the RCAF procedures to fix the problem they believe they have identified.

Second, to the extent the rate is adjusted, use an index without a fuel component such as the all-inclusive index less fuel, AES agrees with Entergy that the provision should work both ways. The mechanism should be expressly limited to recovery, increases and refunding decreases in the fuel costs built into the transportation rate. A true fuel cost recovery method that is fair to both parties would track the increases and decreases in agreed-upon or established price per gallon of diesel fuel at the time the rate went into effect, multiplied by the gallons consumed by the movement.

Third, surcharge that the fuel cost is based upon must be transparent and subject to regulatory oversight. You've heard that many, many times this morning and AES agrees.

To the extent the Board has not already received sufficient data from the railroads it should modify its existing standards to require the railroads to submit the necessary data.

The Board has jurisdiction under 49 USC 10702.(2) to determine whether the railroads' fuel surcharges are an unreasonable practice. AES believes the fuel surcharges implemented by the railroads serving AES facilities are unreasonable practices because they are designed to provide the individual railroad with revenues that exceed the spikes in diesel fuel costs for a particular movement.

AES' written comments set out in detail some of the reasons for why the surcharges do not track costs, some of them you've heard already from other speakers. So, I'll just summarize the points that AES raises which are very similar.

Each railroad employs a surcharge mechanism, multiplies the transportation rate by a percentage derived from the diesel price index. Conceptually because the mechanisms apply a multiplier to the transportation rate, they do not measure the actual fuel cost of a particular movement. Accordingly, the amount assessed essentially for fuel cost recovery bears no relation to the amount of fuel being consumed for the movement.

AES also agrees the WTI and HDF price indexes are not representative of what the railroads actually pay for fuel.

And the written comments include examples of how fuel hedging and volume discount purchasing of fuel by the railroads is commonplace.

The methods also do not measure accurate fuel costs because they do not factor in distance. Accordingly, the shipper with a shorter routing and you've heard already this morning, the higher rate will pay more fuel cost recovery than a shipper with a longer haul but a lower rate.

BNSF's attempt at mileage-based surcharge is in part a result of BNSF's admission that a percentage of revenue surcharge creates disparities between the surcharge and the actual incremental fuel costs.

The formulas are also not based on current fuel prices. They are based on index fuel price levels that have long since been exceeded and not represented as the current cost of fuel as the railroads factor in the new rates.

It must be presumed that some or all of the individual railroads' current cost of fuel is factored into the significant base transportation rate increases for AES' facilities. A representation by a particular railroad to the contrary should be critically analyzed by the Board.

Not raising the index threshold of the surcharge to reflect more current fuel prices built into the transportation rates results in the phenomena that was discussed by Mr. Mohl that you could have a current cost of fuel built into the new rate in the contract, fuel costs would stay flat, yet a surcharge would be assessed.

BNSF admits this in its April 24th announcement that it intends to rebate this current fuel surcharge threshold to $64.00 a ton. It's essentially an admission that the current $23.00 per barrel threshold currently used by BNSF is far too low and results in revenues that exceed fuel costs for particular movements.

Unfortunately, this change has no immediate impact on us yet because it only applies to rates that shoot out to July 1, 2006, when it's implemented.

Do these surcharges as applied to AES actually recover the fuel costs for these movements? AES has performed an analysis for some of its plants and the answer is clearly yes. AES strongly suspects that a similar analysis for all its coal fired plants will produce the same results.

However, AES cannot present this information to the Board in a public forum due to confidentiality restrictions. It's willing to do so if ordered by the Board if that's consistent with the confidentiality provisions in its contract.

But all the data the Board needs to conduct a similar analysis and draw its own conclusions is in the hands of the individual railroads. The Board should adopt procedures for obtaining such data in the most transparent manner possible.

In conclusion, the Board needs to be proactive on this issue. AES believes it is no coincidence that the announcement of the hearing was followed shortly thereafter by NS's announcement of provisions to its tariff fuel surcharge.

Hopefully, continued action and oversight by the Board will result in further changes in other railroad surcharges.

Just real quickly just to summarize AES' suggested recommendations.

Clarify that the surcharges may be used for the purpose of recovering actual costs of fuel expended and refunding or crediting to the shipper decreases in fuel costs. Take appropriate action to correct the current publicly published railroad fuel surcharges which could be the creation of standards for them to follow and require each railroad to submit detailed data reflecting its actual costs of fuel and revenues associated with fuel cost recovery for each movement for which the fuel surcharge is assessed.

Thank you.

CHAIRMAN BUTTREY: Thank you, sir.

MR. TELFER: Good morning, Chairman Buttrey, Vice Chairman Mulvey.

My name is George Telfer. I work for Daimler Chrysler, but this morning I'm representing the Alliance of Automobile Manufacturers, which is an association of 9 finished vehicle manufacturers that have collaborated on this testimony and appointed me as their spokesman.

The importance of our industry in the economy can be seen in the fact that one out of every ten jobs in the U.S. is dependent on the automotive industry. On the other hand, the automotive industry is highly dependent on rail transportation.

We often hear things about captive shippers and so forth and in our industry we can consider ourselves to be captive to this mode of transportation even though we may not be geographically captive to a particular railroad in certain instances.

This can be seen in the fact that about 75 percent of our finished product goes to dealers by way of rail at the distribution points. If this product were to be switched to a highway mode of transportation, it would take a ten-fold increase in the haul away rates that you see carrying cars on the highway, which just wouldn't work on the highway, number one. And number two, there just wouldn't be enough trucks, there just wouldn't be enough drivers to accomplish that.

So, the bottom line is that our industry needs to use rail. It isn't an option.

In addition to the finished vehicles we ship a lot of our materials into our plants by rail as well.

Before getting into the specific copy because of the fuel surcharge, one of the things that the Alliance wanted to make clear is that while we have concerns on this particular topic, and we do want to express, probably echo pretty much, what other shippers have said about the fuel surcharge mechanisms and where we would like to see things go. At the same time, we would like to reiterate that we really are not pushing for re-regulation. I certainly haven't heard that on behalf of other shippers either. But just to make that clear for the automotive industry that we're not looking for regulation. We're just looking for help and a voice in Washington that will help us work with the railroads to achieve the solutions that we think need to be put in place.

One of the things that's been talked about this morning is that, gosh, fuel is going up. Has gone up. It's a problem. It isn't just a problem for the railroads. It isn't just a problem for fuel surcharges, but it's a problem for anybody that drives a car.

It becomes a particular problem that anybody that builds cars and tries to sell them, because number one, the customer is facing this additional cost. But also we're facing additional costs in the ingredients that go into that car because a lot of the things that go into the car are made out of petroleum, plastics and tires and various other components.

So, out costs are going up in many other areas along besides just this fuel surcharge issue. So, we feel the impact of fuel costs in many ways and so we can sympathize in that respect with the railroads' needing to recover that element of their cost. And, there again, echoing the sentiments of other shippers, we're not against railroads recovering that cost. We simply want to see a more equitable mechanism.

In recent years, we've seen railroads implement the fuel surcharges even where in the past we've enjoyed negotiated rates, confidential contracts and pretty much everything that the automotive companies have done with the railroads has been in that arena of negotiated rates and so forth.

However, what's happened more recently is the application of the fuel surcharges on top of this and the fuel surcharges are sort of step outside of that two-party arena and become more of a unilateral mandate on the part of the railroads. Perhaps that was necessary because of the urgency of the situation. But today we're in the position that, as many have expressed, that we may have gone too far.

So, like others, we're seeking, you know, some sort of review of that and step back and say, okay. Where do we go from here?

One of the problems that has been stated is that we really haven't seen the detailed analysis. We don't have the transparency to really see, okay, what are the fuel charges that are being assessed to automotive companies? Collecting the right amount of revenue for the railroads that is equivalent to the increase in fuel cost that it takes to haul our products, to haul our materials into our plants. Or are they, you know, making more money? Are they under-compensated? We just don't know.

So, basically like others, we've had to go to other sources of information and there are plenty of them out there as has been pointed out.

So, we've gone to those sources of information and by and large we've kind of come up with the same conclusions that others have come up with that it kind of looks like we might be paying too much. And this is based on a lot of public information in terms of, you know, how much railroads are paying for fuel. And then, of course, the more confidential information in terms of how much we're paying in fuel surcharges.

So, basically, by doing this kind of an end around analysis, I guess, the Alliance has come to the conclusion that the mechanisms are flawed. And, in fact, work to the financial advantage of the railroads at this point in time.

And as a result, we believe that the ability to mandate these fuel surcharges has become somewhat of a profit center for the railroads. And it's even starting to show up in some of the materials that railroads are publishing to their stockholders and I'm sure others in the room have seen those.

So, as been pointed out, the increases in the surcharges don't necessarily correlate to increases when the fuel itself rises or remains steady.

So, basically, to summarize the specific issues that the Alliance would present.

One, the current revenue-based surcharge, our percentage of the rate charge, do not correlate with the actual fuel costs incurred by the railroads on those shipments. Again, this is echoing what some of the other shippers have said.

So, what results then is that for higher value materials like finished vehicles where the rate is sometimes predicated on the value of the materials that are being shipped or the product that's being shipped, part of what's factored into the rate is the risk that the railroad is taking by handling this high-value product which is probably appropriate in terms of setting the rate.

Unfortunately, when you apply the fuel surcharge to that rate, now you're paying fuel on top of the value portion of the rate. So, we're paying for fuel on the value of our product. Well, because the price of fuel went up, it doesn't cost more to ship this high value product. And this is similar to other points that have been made along those lines.

One of the points that we wanted to bring up that's also been mentioned was the appropriateness of the use of the West Texas Intermediate Crude as a reference point or an index to adjust rates.

Some of the information that we have suggests that since 2001 the price of West Texas Crude has actually gone up at almost double the rate of diesel fuel. So, if you look at the index being used to establish the fuel surcharges, we even wind up paying too much surcharge. And then it kind of doesn't swing the other way because if it comes down to the baseline, then we don't, and the West Texas Crude being a more volatile index, falls below that baseline, then we don't get compensated for that.

One of the things that we questioned and one of the things we're hearing from the railroads is that they're becoming more fuel efficient and we applaud that and we hope that that continues.

In a paper that was authored by the AAR, which is entitled "The Old Review of U.S. Freight Railroads" which was just published the first of this year, they cite the fact that the railroads are three times more fuel efficient than trucks and railroad fuel economy is improving all the time.

Our experience, however, is despite using one-third less fuel, and improving all the time, we're actually paying on a proportional basis higher fuel surcharges for rail than we are for highway carriers. So, there again, it leads us to wonder, you know, is this mechanism working right. And we came to the conclusion that it probably isn't working right.

And then our fourth issue is that we find it frustrating that we don't have the ability to get the information from the railroads to justify the surcharge methodologies.

The requests for supporting documentation basically are rebuffed and the surcharges have become non-negotiable. It's just fuel went up, here's your charge.

So, in summary, there are four things that we're basically requesting from the Board.

(1) Surcharges should cover only the increased cost of fuel and not be a new source of profit for the railroads.

(2) Railroads should fully disclose both cost and revenue data related to fuel purchases and fuel surcharges. So, in other words, you'd see both sides of the ledger.

(3) Surcharges must be based on the price of locomotive diesel fuel used by the railroads and not some other index.

(4) And then finally, number four, railroads move from a rate-based surcharge to a consumption- based surcharge. And that would be something along the line of the 10 miles or something

like that.

So, I'd like thank you on behalf of the Alliance for conducting this hearing. I think it's a very worthwhile thing to do and I really appreciate being here.

CHAIRMAN BUTTREY: Thank you, sir.

MR. NEFF: Good morning, Mr. Chairman, Vice Chairman Mulvey.

CHAIRMAN BUTTREY: You and Mr. Roman are appearing together. Is thatcorrect?

MR. NEFF: That's correct. Yes. I'll do the first half and Mr. Roman will do the second half of our testimony.

Thank you for allowing Ameren to address the Board this morning on the subject to fuel surcharges.

My name isn't Robert Ness. It's actually F-F. And I'm the Vice President of Fuel Supply for Ameren Energy Fuels and Services in St. Louis, Missouri.

My responsibilities include the acquisition of coal and related transportation for all

Ameren's electric subsidiaries.

The purpose of my testimony this morning is to address the impact of railroad fuel surcharges on Ameren's coal-fired generation. This testimony is given in support of Ameren's written comments which were filed previously with the Board.

Ameren is the largest shipper of Powder River Basin coal in the country, shipping over 35 million tons annually. Ameren's plans rely on rail service as their primary mode of receiving their fuel. Our average haul is over 1,000 miles and our annual freight costs are expected to be over $550 million in 2007.

As are many shippers, our transportation on a whole is transitioning from fixed price confidential contracts to public pricing tariffs. And these new public pricing tariffs are being implemented by the western carriers often contain a non-negotiable fuel surcharge which made a significant impact on Ameren's full generation and Ameren's customers.

As an example, assuming that the diesel index remains at its April 15th, 2006 level of $2.70

per gallon, Ameren's fuel surcharges next year will add up to $83 million. And with other shippers, the amount of the fuel surcharge that Ameren pays will go up and down depending on the price of the fuel-related diesel index.

Clearly, the fuel surcharge will amount to a large sum of money for Ameren and its customer. We, in turn, will have to recover that amount from our customers.

Now, Ameren does not dispute that railroads should be able to recover their increases in fuel costs. We have generation in coal, natural gas and fuel oil and we're familiar with the volatility in the fuel markets and the need to recover the fuel costs.

Utilities have an even larger percentage of their product costs tied to fuel than do the railroads. And most utilities are familiar with fuel hedging and fuel cost recovery methods.

First of all, I want to say fuel cost recovery should not be a mystery to the parties involved. Utilities have been recovering changes in their fuel costs for years through fuel adjustment clauses, purchased gas adjustment mechanisms and similar regulating tools.

Utilities understand the importance of recovering fuel costs, but we also understand that customers or regulators must be able to understand and be comfortable with the fuel adjustment mechanism.

With the utility fuel pass-through clauses that are generally regulated by state public service commissions, we found that what we would call poor common attributes of fairness. And I posted these on the screen here.

The first attribute of fairness we would call is the recovery of utility fuel costs should be based on actual cost that utilities incur.

The second attribute of fairness is that utility pass-through mechanisms are transparent. We've heard that term a lot this morning. The transparency of costs. That means all parties should know what costs are included, how the costs are calculated and the methodology of the calculation.

The third point is that utilities are not allowed to over-recover or benefit from this cost recovery of fuel. It is strictly recovery.

And the fourth point is that utilities are required to take actions to minimize the impact of volatile price changes in commodities like fuel through hedging programs and prudent purchasing practices.

Ameren believes that these attributes of fairness which are applied to utilities should also be applied to the railroad cost recovery mechanism. But we find that none of these characteristics are present in the fuel surcharge mechanism as currently practiced by the railroads. Many of the previous speakers had expressed the same thoughts.

It is Ameren's position that the fuel surcharge mechanisms imposed by the railroads in their public pricing tariffs do not adequately reflect the true cost of the increases, are not transparent enough to provide comfort to customers that the charges are fair and they're not structured to prevent over-recovery of fuel costs.

To address these issues further, Ameren

has retained a recognized expert who specializes in contract escalations and I would like to turn the remainder of our turn over to Mr. Jay Roman of Escalation Consultants.

MR. ROMAN: Good morning. Chairman Buttrey, Vice Chairman, Mulvey.

I appreciate the opportunity to address the Board regarding fuel surcharges on behalf of Ameren.

We want to commend the Board for having this hearing. As you can see from the large number of people we have in this room, it's a pretty hot topic. People are really interested in it and I think everybody appreciates the attention that you're giving to this issue.

I'm here today on behalf of Ameren to explain irregularities in the manner in which railroads are imposing fuel surcharges on shippers.

At Escalation Consultants we do quite a bit of work with fuel surcharges and our findings support the prior testimony of Ameren that there are problems with the railroad fuel surcharge programs.

The first attribute of fairness made by Ameren which is up on the board is that fuel surcharge cost recovery should be based on actual cost incurred by railroads. This is contrary to the methodologies established by railroads in these programs.

As an example, both western railroads use on-highway diesel fuel price to initiate their fuel surcharges. This the retail price index that is reflective of what on-highway vehicles pay for diesel fuel. This is not reflective of how the railroads incur their costs. All the class one railroads buy diesel fuel in bulk and pay wholesale prices, not retail prices for fuel.

The largest problem is, however, that fuel surcharges are applied against the entire rate, rather than just a portion of the rate associated with the fuel expenses. This application increases portions of the price for things other than fuel like labor and benefits and overhead, lots of expenses as well as profit.

The surcharge programs the railroads employ are very distant from the actual costs they incur. And this causes serious concerns about the accuracy of these programs. Based upon my more than 30 years of experience with price escalation issues, I find that if you are escalating a very volatile cost like fuel by an escalation method that is not closely related to the cost that's actually being incurred, you're going to get very inaccurate results.

The analysis that we've done on this demonstrates that's what's happening.

Ameren's code of fairness number two is that fuel pass-through mechanisms need to be transparent and that all parties needs to know what costs are included. We've heard that a lot here today.

Rail fuel surcharges are based on fuel costs in late 2001 and early 2002. As a result there are now a total of four years of escalation included in these programs. It is not clear why surcharge programs allow railroads to charge shippers for four years of escalation on top of current rates. But what we do know is that these surcharge programs are asking shippers to accept that none of the large rate increases they have received since 2001 cover any portion of the increase in fuel expenses that have occurred in the last four years.

It is very difficult to accept this assumption without any type of documentation from railroads which demonstrate it's an accurate assumption.

From an analyst's standpoint, the greater the number of years of fuel escalation included in these surcharges, the less transparent these surcharges become.

In the future when we get even farther away from the base fuel cost and the surcharge, father away from 2001, this lack of transparency with these programs is going to increase.

Ameren's point of fairness number 3. The fuel surcharges should not allow over-recovery is in conflict with the railroad's fuel surcharge programs because these programs appear to double count the cost increases.

The fuel surcharge programs of railroads are essentially asking shippers to accept that railroads are recovering the increased cost of expenses like labor and overhead through rate increases over the last four years but at the same time there is no recovery for the increased cost of fuel. This is very difficult to accept and it's a reason many shippers are concerned that fuel surcharges are double counting fuel cost increases.

Concerns about double counting of fuel increases are not being ameliorated by railroads as they have not provided anything to demonstrate the fuel cost increases since 2001 have been broken out from other expenses and removed from rates. Many shippers have incurred large rate increases over the last four years. This makes it hard to accept that none of these increases cover any portion of the railroad's increased cost of fuel.

Ameren's fourth and final point of fairness is that railroads should be expected to minimize their fuel expenses through hedging programs and prudent purchasing practices. Railroads like public utilities should have the obligation to keep costs down to the best of their abilities. This includes utilizing a well thought out reasonable hedging program with both financial and physical hedging.

As substantial consumers of fuel oil, railroads are in a unique position of being able to perform large-scale physical hedging. And in many cases, they're already doing this.

As a consumer of the actual commodity, the railroad's ability to hedge is much better than that of a shipper and railroads should strive to maintain the lowest fuel cost possible.

In conclusion, Escalation Consultants finds that the current fuel surcharge programs are illogical and I must say also confusing. Our analysis also demonstrate that railroads are over-recovering their fuel cost for these programs.

This afternoon in the consultants' portion of this hearing, I'll demonstrate how that is happening and some numbers on that issue.

Also this afternoon our proposal on how railroads' reporting requirements should be adjusted to provide rail customers and regulators with better information on carrier's fuel cost and the revenue collected through these surcharges will also be presented.

This concludes my testimony and I thank you for allowing me to address the Board on this issue today.

Thank you.

CHAIRMAN BUTTREY: Thank you, sir.

I thank the entire panel for being here today and for giving testimony in the hearing.

There seems to be a lot of interest among the shipper groups in finding some type of index which might be used for any type of analysis in the future. And I was wondering if there was any kind of unanimity out there on this panel about what that index might be?

There are those who say that coming up is some kind of nationwide index would not be appropriate because fuel prices fluctuate, because of the geographic differences around the country, nobody is convinced that of that apparently that are being afoot. I'd be interested in knowing what your thoughts are on that.

MR. ROMAN: There is a proposal or a recommendation that we're making this afternoon which these surcharges are applied against revenue. And they're applied against revenue to generate the increase in money that the railroads need to recover their fuel expenses. So, you have this relationship between fuel expenses and revenue. There could be an index that would be foreign which would reflect that fuel expenses are a percentage of revenue.

And if that is formed into an index that change would be reflective of how--essentially, it would make sure that the railroads would be no better off or no worse off than they were before fuel costs actually increased. But I'll go into that more in the presentation this afternoon.

MR. CROWLEY: May I add to that?

I think in the presentation that I made, which seems like hours ago, we still--I had you choose graphs and the graphs measured the exchange in the index that is already published, the fuel component of the RCAF unadjusted, pretty well tracks the changes in both BN's and UP's fuel costs. So, I think you have the mechanism in hand to track actual fuel cost changes.

MR. TELFER: Right, and from the auto industry, I think we would align with what Mr. Roman said with regard to some sort of an index that comes right from the railroad's actual costs. I think he's suggesting that the actual cost be used as a percentage of revenue and then track the fluctuation as a percentage. But adding to that, which maybe doesn't need to be added but I will, is that by no means that we would want to stay with the surcharge applied to the rate. So, while the index would be derived as a percentage fluctuation of fuel versus revenue, that doesn't mean that we would apply it to the revenue. But we would prefer to have it applied in some other measure such as ton miles.

CHAIRMAN BUTTREY: Mr. Neff, the grain shippers from this morning seems to think you're getting a pretty good deal on your fuel surcharge. I don't know if you were in the room or not, but they seem to think that you're coming out pretty good.

Apparently, there is a huge difference between the fuel surcharge that's being applied to grain and to coal.

Can you explain why that might be true?

MR. NEFF: No. We don't ship any grain. I wasn't really aware of the differences until this morning. We have mostly our coal rates, so I can't explain the difference.

CHAIRMAN BUTTREY: Does anybody have any remarks on that?

MR. PFOHL: I'll just add that we demonstrated in our testimony that the surcharges as applied to coal movements, the railroads are over-recovering. And so there may be a difference in degree of over-recovery, but certainly coal shippers do not believe they are getting a good deal under the current implementation of--

VICE CHAIRMAN MULVEY: Everything is relative, I suppose.

We've heard a lot of discussion about the methodologies and the fairness of the way fuel surcharge are calculated which would be the proper indices, et cetera.

But in reading your testimonies, you also address the issues of the Board's authority. This is critical. What is the Board's authority in this area? There is some reference to the ICC’s Ex Parte 211 hearing. I think in that hearing the Commission was inclined to look at the RCAF as a way of getting at the increased fuel cost problem, rather than fuel surcharges.

And having said that, could you, and in most of your testimonies, did a very, very good job in addressing this issue of the Board's authority, comment on whether or not the Board has authority, whether or not this, in fact, is an unreasonable practice versus whether it's simply a rate issue and therefore if we're going to consider it, we should consider it in the context of a rate case?

MR. MOHL: From Entergy's perspective, we segregate what the base rate will consist of compared to fuel costs. And we think this fuel cost is an adjustment and not a rate that would come under your authority. And as both Mr. Neff and myself have testified, this is not uncommon at all and we're simply looking for a reasonable way and a practical way to ensure the railroads get compensated for fuel and their base rate issues remain outside of your jurisdiction. But these adjustments legally, strongly come under your jurisdiction.

VICE CHAIRMAN MULVEY: Others on this issue?

MR. TELFER: I think, and again, I'm not a legal expert.

It is a critical issue and I think from the automotive perspective what we tried to state was that we enjoyed the environment that has existed in the last 25 years. We think that it's done a lot for the partnership between the automotive shippers and the railroads. And we want to continue with that arrangement with regard to rates.

However, the fuel surcharge has not been presented by the railroads as a rate issue, but simply a means of recovering this uncontrollable cost.

We support the recovery of that uncontrollable cost, but we question the methodology.

So, therefore, I would say it's not a rate negotiation issue, but more of a methodology issue that needs some oversight.

VICE CHAIRMAN MULVEY: Well, this afternoon or tonight we'll be discussing the issue as to whether or not there's a way to address this but there's a difference of opinion on how we should deal with it.

A number of you addressed some of the law. Both Mr. Buttrey and I have figured out that the precedent in this area is fairly thin. So, if you can cite some cases--

Mr. WILCOX: There are a couple of decision early on. It's, I guess, the Parrish Heimbecker cases. I'm sorry, I butchered the name, where there used to be the light density fuel surcharge, a commodity surcharge on, I guess, 1070520 or whatever, that was a statutory authorization for surcharges. Then that was repealed and I believe in one of those decision, the Board S&C then said that that authority has gone away, but the Board still has jurisdiction under 10702 for unreasonable practices.

I think you said something earlier that it depends on how it's assessed. And I think the cases are all over the map, but I think there is authority for treating, you know, the manner in which the actual mechanism does what it was represented to do, whether that's a reasonable practice or not.

And so it's sort of a bottom up analysis whether you can set standards that, in effect, will establish the level of the surcharge but really from the bottom up in terms of what are the correct parameters to establish.

VICE CHAIRMAN MULVEY: There's always the measure fairness or reasonableness. Everybody wants this to be fair but I'll try just to be reasonable and whether or not what the railroads are doing is a reasonable practice.

But if the railroads couldn't cross subsidize and we all recognize that the railroads are unable to levy fuel surcharge on all the traffic that they have because of contractual restrictions, therefore, if they could only level a cost-based-- special cost-based surcharges on the traffic they could assess, they would have to eat, if you like, the other cost increases on most contracts where they couldn't. And we'll talk later about what percentage that is.

What would that do to the railroads bottom line and would that really hurt the railroads in terms of their ability to make the investments in the infrastructure that everybody is so concerned about, the capacity?

Where are the coal companies and the shipper and the utilities especially concerned about making investments in the Powder River Basin to make sure that their coal is flowing?

Would we compromise that if the railroads couldn't recover their total costs even if it meant some--

MR. CROWLEY: I don't think your premise is quite correct. You're assuming that all of the people that don't get this so-called fuel surcharge, all of the contracts that don't have a specific fuel surcharge are not paying the increased cost associated with the fuel. I think that basic premise is incorrect.

I think I demonstrated this morning that if you have an RCAF or if you had any index in your contract, that is recognizing the increase in fuel, if it's the RCAF it's in the railroad industry. If it's a GDIPD or some other general commodity index, that recognizes the increases in fuel in the industry as well.

So, I think we're talking more about a timing issue than a recovery issue. I think the timing is --there's a slight difference in the timing between when the fuel surcharge is implemented and when the RCAF is implemented. But that's all it is. This doesn't compromise monies for investment and infrastructure at all.

VICE CHAIRMAN MULVEY: Well, the RCAF comes out quarterly. And I guess the rail fuel is available monthly.

Would it be possible to come up with some sort of new RCAF which would take into account the more current changes in fuel costs so we'd have, say an RCAF monthly fuel index or RCAF and--but a fourth

RCAF is you like. An RCAF MF which would have the monthly fuel costs adjustments along with the regular RCAF changes which come quarterly.

MR. CROWLEY: I don't think there's any problem with having a more frequent RCAF. I think that's something that can be done. But again I'm not sure that it's necessary.

In the development of a quarterly RCAF, the Association of American Railroads is forecasting what they think the fuel price will be and that is what you're basing your RCAF increase on. So,if their models are not correct in forecasting, then it's caught up in the next quarter. But if they're over-forecasting, they're over-recovering in that quarter.

So, to the extent we're talking about some slight noise here in the difference between what the forecast is and what the actual is for that particular quarter. But if you want to go more frequently, go more frequently but stay with what you have. It's working. Just make sure that it's implemented.

CHAIRMAN BUTTREY: Mr. Roman, maybe I heard this wrong, but there seemed to be some suggestion this morning that there might be some way that these fuel surcharges could be calculated on a per car rate, depending on the commodity of the merchandise being shipped.

Is that something that makes sense to you? Maybe even the whole panel here. Is that something that might--

MR. ROMAN: Well, it depends. There's lots of things you can do that have the fuel surcharge based or that actual cost for the movement. And from a common standpoint, I mean, you would always like to have the method as closely related to the costs that are being incurred as possible. It's just a question of how much administrative time and effort is associated with developing that escalation method.

The railroads complained and said we don't want to have, you know a thousand different things that we need to administer around here. It certainly can be done. It's a question of the administration that it actually takes to do it.

CHAIRMAN BUTTREY: When you say administration, you're talking about the software development?

MR. ROMAN: Well, the software development and it takes more people to do, you know, a thousand different ways than it takes to do one.

But I actually think this issue that we're addressing here and if you really want to solve this, there's really two problems.

One is the fuel surcharges the railroads are applying. And the other is, the Board really needs to have the information in front of them to really see how these provisions are performing.

And some of the things in determining what you actually want to have, I think you have to have the data in front of you to show how well they're performing. Because if you want to structure something that's more closely related to the change in cost, you need to know what's good and bad about the current fuel surcharges. As we've looked at is, you need the input. You need a certain amount of information for the Board to very quickly and easily analyze these programs. Once you know how these programs are performing, it's much easier to actually develop what you actually want with these fuel surcharges.

And I look at a little of this as Tom was saying, maybe you can just use the RCAF. You can use existing things that are there.

But regardless of what you do use, I think if there's something that could be good to come out of this it would be that the Board would have the information they need to really have an educated assessment of how well these surcharges actually are performing.

And to me I thought out as the first step.

There's lots of things that can be developed, but if they're going to make it any better or they're going to be onerous, those kind of get knocked by the wayside for various reasons.

And so my presentation this afternoon gets into things that would be very helpful to the Board to really see, to make a better assessment of these programs and then go on from there.

VICE CHAIRMAN MULVEY: Yes, Mr. Telfer.

In your testimony you talked about the

fact that you were not a captive shipper. But isn't it true that the percentage of the automobiles moving out of your plant was about 40 percent when the exemption was granted to your industry as an exempt commodity compared to 75 percent today?

MR. TELFER: I'm not familiar with that statistic. And my tenure in transportation goes back to just after the implementation of the Stagers Act. So, my experience prior to that was in the plants and in the flow of materials in the plant.

However, going back the last 20 years, let's say. I don't think that our percentage of vehicles within my company that are shipped by rail has appreciably increased. I think it's been right around the 70 to 75 percent level. Whether that's changed substantially with other automotive shippers, I just don't know. Certainly, the importers who have, you know, several of our members are headquarters/transplants. And for those companies over that period of time they've migrated from importing a lot of their product which would have necessarily involved a lot of rail shipping from the cost in, even though the costal areas are heavier marketed areas to shipping from domestic plants. And that, you know, warrants a whole different distribution pattern.

So, some of those kinds of things could be influencing that too.

VICE CHAIRMAN MULVEY: I am addressing the problem of double dipping. Mr. Crowley has suggested that the railroads today are pretty much fully recovering their increased cost of fuel through the RCAF. And that the fuel surcharges that they're receiving beyond that really are just going to the bottom line. And most of them are in excess of what fuel cost increases are.

Is that fair to say?

MR. CROWLEY: That's fair.

VICE CHAIRMAN MULVEY: Okay. Well, that's all I have then too for the time being.

Thank you very much.

CHAIRMAN BUTTREY: Thank you very much.

We have about 17 minutes until we are breaking for a lunch break. We're going to try to keep that schedule. So, the next panel, which is the third panel, Concerned Captive Coal Shippers, Total Petrochemicals USA, Inc., Arkansas Electric Cooperative Corporation, Degussa Corporation, Potlatch Forest Product Corporation, Griffin Industries and Graniterock.

I'd just like to put the panel on notice, if we could, for housekeeping purposes here. We're probably going to have to break this into two pieces. Maybe not legally break it, but we're going to try to adjourn here at 12:00 or as close to 12:00 as we can comfortably do that and reconvene at 1:00. I'll put the panel on notice to that here.

We'll get as far as we can and then we'll break.

So, I'd like to welcome the panel to the Surface Transportation Board today and would you please, as we have been proceeding from my left to right, so if everybody is ready, we'll go ahead and start.

You may proceed.

MR. LOFTUS: Thank you, Chairman Buttrey

and Vice Chairman Mulvey.

My name is Michael Loftus. I'm appearing along with Mr. Heller on behalf of the Concerned Captive Coal Shippers group that have filed comments. The members of that group are listed in the comments.

I would like to make a few quick points and then turn it over to Mr. Heller.

First, we'd like to applaud the Board for initiating this proceeding on what is a very important issue for coal shippers as reflected in what you've already heard.

Second, we believe that the Board fairly has jurisdiction to deal with the reasonableness of the railroads' fuel adjustment mechanisms as rules and practices. We do not believe that an argument to the effect that the fuel surcharge has to be considered a part of the rate and can only be used as an issue relating to the reasonableness of the overall rate is a sound argument.

And I would direct your attention in that regard to pleadings filed by Norfolk Southern in Docket Number 42072, Carolina Power and Light Company

v. Norfolk Southern Railway Company. That issue arose as you may recall in the initial decision the Board found the rates to be unreasonable. And then an issue arose as to whether the fuel surcharge could be assessed on those rates.

And if you'll look at NS's filings on 10/4 and on June 18 on the fuel surcharge issue, you will see that they've characterized the fuel surcharge as a rule or practice and not as a part of the rate.

Third, we believe the Board correctly articulated the issue that you should be looking at in this matter and that is: Are the revenues being recovered through the fuel surcharge mechanisms, "directly and closely correlated to increases in the cost of fuel for the particular movement to which the surcharge is applied"?

We believe that is clearly the question you should be examining. And as Mr. Heller will address, we think it is very clear that the existing fuel surcharge mechanisms do not satisfy the standard.

Fifth, the Concerned Captive Coal Shippers group requests that the Board be clear in this proceeding that to be reasonable, a fuel surcharge mechanism should satisfy the standard I referenced a moment ago. Second, you should give the railroads a reasonable period of time to develop conforming fuel surcharge mechanism. Then after that period has passed, you should on complaint disallow any fuel surcharge mechanism that does not conform to that standard.

And, finally, where is the Board to direct the railroad to report additional fuel-related data to the Board as we have set forth in our comments?

Thank you.

Mr. Heller.

MR. HELLER: Thank you, Chairman Buttrey and Vice Chairman Mulvey.

My statement specifically analyzes the manner in which fuel surcharges are currently being implemented for specific coal movements.

In my testimony, I've compared the incremental fuel costs incurred by specific railroads resulting from higher diesel fuel prices associated with specific movements to the incremental revenues that they're receiving under the various fuel surcharge mechanisms for the coal traffic.

I performed this incremental cost verus incremental fuel surcharge revenue analysis to three typical coal movements from the period 2003 to 2005. One was an eastern movement. Two are western movements. One using the revenue based fuel surcharge mechanisms and the other using the BNSF mileage-based surcharge mechanisms.

Under each of these scenarios using typical rates and distances for coal movements, I show that the fuel surcharge significantly over-recovers the actual diesel fuel costs incurred by the railroads for each of these movements. That's similar to testimony you've heard from others.

In the case of the eastern movement on the Norfolk Southern, the recovery is 265 percent more than fuel surcharge revenue than it incurred in additional cost for the same period.

I know that BN has since decided to alter its approach as was discussed previously. It intends to embed the fuel surcharges into those rates.

Under the existing approach which provides a shipper with minimal data about the fuel surcharge over-collections, I don't now that this approach accomplishes anything much more than making it more difficult as was pointed out previously to assess what portion of the fuel surcharge revenue increases are recovered under other mechanisms versus the fuel surcharge mechanism.

In the case of the Burlington Northern using a revenue-based fuel surcharge mechanism in place during 2005, I calculated that the fuel surcharge generated 84 percent more revenue for a typical coal movement than BN incurred in increased diesel fuel costs.

I then did the same calculation using the BN implemented car mile mechanism, same movement parameters and found that the example coal movement recovered 127 percent more than fuel surcharge revenue of the movement incurred in diesel cost increases.

This doesn't imply that a car mile-based fuel surcharge mechanism will always recover more than one based on revenue. It depends on the rate levels, the movement and the distances involved. But it does indicate that simply switching the form of the fuel surcharge does not necessarily remedy the over-recovery issue.

The level of the fuel surcharge even if it is based on parameters that more closely parallel the costs incurred in movement is important.

While the focus is on the fuel surcharge, it is important as Mr. Crowley pointed out to note that many railroad rates are also subject to the RCAF. In my paper I've shown the increase in the RCAF between the first quarters of 2003 and the fourth quarter of 2005. Over half of the RCAF increase during that period are a rate equivalent to 2.7 percent in the actual rate is driven by fuel price.

While the railroads focus seems to be on comparing the fuel surcharge revenues with changes in diesel costs, it's important to note that fuel surcharge is not now and never has been the only cost recovery mechanism for increases in fuel prices.

When measuring the relationship between revenues recovered by the carriers from the fuel based cost adjustment mechanisms, it's important to consider the impact of the RCAF as well as the fuel surcharge.

Hedging has also been used by many of the carriers as discussed previously to mitigate the impact of diesel fuel price increases. I noted that some of the carriers' submissions before this panel specifically exclude the effects that hedging when we compare fuel surcharge recovery with increased diesel fuel costs. This will generally in the current environment cause the railroad comparisons to overstate the cost increases that they have incurred.

It also appears from various cites that I present in my paper the financial reports of the individual carriers as well as financial analyst reports during the last three years, some of the carriers took in more in fuel surcharge revenue than their increase in fuel costs.

As the carriers apply their fuel surcharge to a greater volume of coal traffic, carrying higher base rates as was pointed out previously, the effect of the fuel surcharge over time will likely be to accelerate the discrepancy between changes in diesel-related movement cost and the fuel surcharges.

With regard to your question about reporting mechanisms, I recommend that the Board collect and make available to shippers data which would better demonstrate this relationship between revenue collected as a result of fuel price increases under both a fuel surcharge program and a diesel component of the RCAF or other cost recovery mechanisms as a prelude to considering exactly what form of fuel surcharge would better match movement specific revenues and costs. I'm not sure that data is available right now.

I present specifics in my paper on types of data that are needed for that.

The railroads' contention that movement specific cost analysis would be unwieldy, could be true if it was done with very granular data, but I don't think that's necessary. Whole spectrums of options exist between a percentage-based fuel surcharge and something that looks like a cost analysis.

A program, for example, that aligns

movements specific to fuel surcharge revenues and costs use metrics such as car miles or gross ton miles rather than revenue bases for assessing the fuel surcharge. However, as the BNSF examples shows, simply switching to a distance-based measure doesn't necessarily rectify the over-recovery problem.

Thank you for the opportunity to speak today.

CHAIRMAN BUTTREY: Thank you very much.

I think what we're going to do now is interrupt you right in the middle of these comments to break here for lunch and reconvene the hearing promptly at 1:00. Thank you very much.

(Whereupon, the hearing was recessed at 11:53 a.m. to reconvene at 1:00 p.m. this same day.)

A-F-T-E-R-N-O-O-N P-R-O-C-E-E-D-I-N-G-S

1:02 p.m.

CHAIRMAN BUTTREY: Welcome. Will the hearing come to order please? We're resuming our hearing we began this morning. Glad to see you all -- most of you all actually came back.

We were in the middle of the third panel, Shipper panel. Mr. Slavin was about to speak when I hope kindly interrupted him so, we could take a break for lunch. We'll try to be as civil about this process as we can be. So, we'll resume with the third panel, Shipper panel, this afternoon.

Mr. Slavin, you may proceed whenever you're ready.

MR. SLAVIN: Chairman Buttrey, Vice Chairman Mulvey, thank you for this opportunity to speak on this issue.

My name's Dan Slavin. I'm the Rail Service Manager for Graniterock Company and I'm going to speak a little bit on the effects of the fuel surcharge program that we're currently using on Graniterock and the communities in which we operate.

A little bit as background, Graniterock's a 106-year-old family owned construction materials and general engineering contractor. In 1992, we were the recipient of the Malcolm Baldrich National Quality Award.

Graniterock has been doing business with the railroad for its entire 106 years as the very foundation of the company was first centered around supplying railroad ballast to the railroads for expansion.

The company now supplies construction aggregates from Wilson Quarry near Watsonville, California to rail served locations from San Jose to San Francisco. Those are hauls from 40 to 90 miles.

These branch locations rely solely on the Union Pacific for daily rail service as congestion on highways and surrounding neighborhoods makes delivery of aggregates by truck impractical and undesired by local municipalities.

In the peak construction season, our rail shipments run between 90 and 115 rail cars per day. This averages out to anywhere between 11,000 and 18,000 rail cars per year.

The nation is again experiencing an unpredictable large increase in the cost of diesel fuel as we all know. The increased diesel expense is a fact of life that all American business must deal with and we believe that the use of a fair fuel surcharge program is an acceptable method for recovering the unpredictable fuel cost increases. A fair fuel surcharge program only recovers the additional fuel expense and nothing more.

The current UP fuel surcharge is rate based using the national HDL average. We're unhappy with this program as implemented because we believe it over collects the actual fuel increase for our rail movements.

Taking 2001 as a base year, our analysis of railroad data indicates that for the combined 2004/2005 period Graniterock overpaid the additional fuel expense by over $240,000. In other words, the fuel surcharge was about 26 percent greater than required to recover the additional expense.

We believe that not all rail customers are paying the fuel surcharges. This practice, we believe, is a form of discriminatory pricing.

A recent Wall Street Journal article reported, the article was in the April 18th edition of this year, that the UP says it spent 1.38 billion more on fuel last year than it collected in fuel surcharge revenue partly because some long-term contracts lack surcharges.

This is consistent with the fact that the surcharges -- fact that the surcharges exceed the increased fuel cost, but at the end of the year, UP's financial disclosures indicate that the amount collected is not sufficient to cover fuel costs. Therefore, clearly, not all customers are paying the charge.

It appears that captive rail customers like Graniterock are forced to pay an excessive fuel surcharge to compensate for larger noncompetitive, non-captive shippers that are unwilling to pay the additional surcharge or have contracts. We believe this is unfair and must be corrected.

Excessive fuel charges coupled with higher than justifiable rate increases over the past two years are forcing freight back on to already congested highways and neighborhoods. This trend is not working in favor of American business and the American public.

The railroads must treat all shippers fairly. This includes captive shippers. A fuel surcharge must only collect the increased fuel expense for that shipper and nothing more. Captive shippers should not be expected to pay the surcharges the railroad cannot collect from larger non-captive shippers.

We seek the STB to intercede for all rail shippers to insure that railroads design and implement fuel surcharge programs that fairly recover only additional fuel expense for their rail movements. Captive rail shippers should not be held hostage to pay the expenses incurred by larger non-captive shippers.

Please note that Graniterock is charging its customers a surcharge on diesel fuel, asphalt used in our hot mix and other products that use petroleum products. However, these products are -- these surcharges are sufficient to cover only our increased costs and are not used to supply another source of profit. Not only do we believe that this is fair, but in our competitive business, no other surcharge method has been acceptable to our customers

And just in summary, re-stressing some of the points other speakers have made this morning, surcharges must be cost based, transparent and subject to oversight and thank you for this opportunity to speak.

CHAIRMAN BUTTREY: Thank you. Mr. Sharp.

MR. SHARP: Thank you, Chairman Buttrey and Vice Chairman Mulvey for the opportunity to address this issue before you today.

I am Steve Sharp with Arkansas Electric Cooperative. We own parts of three coal-fired plants in Arkansas that all burn Powder River Basin coal. So, obviously, our interest is in shipment of coal out of the PRB and I would invite you, Chairman Buttrey, if you've never fished in Arkansas, we've got some wonderful fishing. Especially trout fishing on the White River. It's really -- if you've never done that, really it's -- it's really --

CHAIRMAN BUTTREY: Actually, I have done that. Very successful.

MR. SHARP: I can tell you're a true fisherman if you done --

CHAIRMAN BUTTREY: I spent 22 years in Memphis. So, close enough.

MR. SHARP: Oh, you were close by. Very good.

From our standpoint, I'm just going to go very quickly over some highlights. We have submitted testimony. With your permission when I get done, I've got another piece that we'd like to submit to the Board after today that actually I just got -- just got completed last night. I'll just go very quickly.

From our standpoint, the fuel surcharge issue is a perfect example of what happens when you don't have an open competitive market for freight transportation. To our way of thinking, that's a lot of why we got to this point.

We've got no problem with the concept of recovering unforeseen fuel costs in the type of tariff environment that the railroads are pushing towards, but we've seeing this implemented on a unilateral basis, you know, without input from the customers and like I say, we've already seen a couple of them change the system that they implemented not too long ago which there again is another indication that this wasn't necessarily well thought out and properly constructed system to begin with.

And we do have concerns that in a lot of the instances cost of these fuels and even indices are even being applied to the cost of these fuels that were meant -- originally at least meant to account for cost increases in the fuel. That there may be some double dipping in some of the cost going on.

But, we've also got a concern that as the Board looks at ways of improving this fuel surcharge situation that we retain some element of encouraging increased efficiency and increased productivity with the railroads. There's -- we've got a little bit of concern if the railroads are totally divorced from the fuel cost and the -- even the rate at which they're consuming fuel, that there will no longer be an incentive to push for higher efficiency locomotives and that sort of thing. We'd like for that to be preserved in this process if it's at all possible.

Another issue that I hadn't heard mentioned a lot this morning and starting back this afternoon, the highway diesel fuel that both UP and BNSF use to index their fuel surcharges through is in our thinking not a perfect way of doing this certainly and others have spoken to some problems with it, but our attorneys discovered that this is going to get a little worse even as soon as this fall.

The on-highway diesel fuel operators are going to be required this fall to comply with some new EPA requirements to phase in ultra-low sulfur diesel fuel for highway use. That is going to cause an increase in over-the-highway diesel costs. It's not going to have any effect on the diesel that the railroads purchase.

So, this is going to further disconnect. The railroads do have to convert to this low -- ultra-low sulfur diesel fuel, but not until 2012. So, there again, we would urge the Board to consider some way of disconnecting this highway diesel fuel index from the fuel surcharges before it gets even further out of kilter.

And the other category that I'd like to emphasize which some people have mentioned, but to our way of thinking, the effect that these fuel surcharges will have on -- is having and will continue to have in the future captive shippers, something that we're particularly sensitive to.

One of our large coal-burning plants is completely captive to the UP and, therefore, pays a higher rate to get that coal delivered to that plant and as long as these fuel surcharges are being applied to the rate and not to something that better appropriates what the actual fuel cost is, the captive shippers who are already paying higher rates because of their captivity and because of the situation that we find ourselves in with the railroads are just going to be hurt worse because it's that multiplying escalating affect that several people have already talked about and so, we would like to see -- we would like to see a different mechanism that did not -- does not apply to the entire rate.

In -- in part in response to the Board's request for this hearing, we did undertake to make an example of a couple of our plant situations and come up with some specific numbers that we thought would represent the railroad's fuel cost, the increase in their fuel cost and the increase that -- in revenue that they're going to get under the surcharge amount and that's the work I was referring to that was just finished last night and we'll submit that with the Board's approval. So, you will have that and everyone will have access to.

But, very briefly and this is our Independence plant in Arkansas and our White Bluff plant in Arkansas and this analysis was done by a consultant of ours and we did not use any confidential data at all. This is all using public numbers trying to come up with estimates for what the actual fuel cost was and what the surcharges would do.

In the case of the Independence plant, the fuel surcharge mechanisms over collect by $8,000 per train. Now, this plant takes approximately 375 trains a year. It's a little more than one a day. So, that would result in an excess fuel revenue collection of $3 million a year just for that one plant. Just for that one power plant in Arkansas and we believe this is a very conservative estimate and you can judge that for yourself when you see the numbers.

The other plant that we did the study for the White Bluff plant, it is in somewhat of a competitive rail situation with Burlington over there in UP.

The analysis of their different fuel surcharge mechanisms showed that as far as over collection per train, they're over collecting almost -- would over collect almost the same amount under the different fuel charges -- fuel surcharge mechanisms of about $4,000 per train.

So, at that plant using this conservative method, it's about $1.5 million per year of over collection. So, we will submit that.

And there again, I appreciate the chance to present these comments and our written testimony and be able to answer questions at the end of day one.

CHAIRMAN BUTTREY: Thank you and those have been read.

MR. SHARP: Thank you.

MS. ELHAKIM: Chairman Buttrey, Vice Chairman Mulvey, my name is Diane Elhakim and I'm the Logistics Manager for Degussa Corporation based in Parsippany, New Jersey and I'd like to thank you for giving me the opportunity to speak to you today.

This morning we heard individuals speak for many shippers and associations represent entire industries.

I am a shipper. I am a shipper and one of Degussa's core businesses is chemical and not only am I a chemical shipper, I am a captive chemical shipper.

And this morning, we heard about the practice of the railroads in assessing fuel surcharges as a percentage of the rate and historically chemical rates, presently and historically, are assessed some of the highest rates in the rail industry and the captivity factor adds to that.

So, I have submitted written testimony. In the interest of time, I just want to briefly touch on the focus of my testimony being that the unfairness and unreasonableness of the fuel surcharge being assessed as a percentage of the rate.

Speaking to you as an individual shipper today, I would just like to make a case in point. Degussa Corporation has embarked on a major project which involves millions of dollars, the construction of a plant, the procurement of a rail fleet which is no easy feat today given the long wait for cars. It was my task to procure a long-term rail contract for this move and I had in my hand an offer for a five-year contract with escalation factors based on indexes, the RCAF, for four years after the initial term.

After a short absence from the office, I came back to find my voicemail full of people on the project saying that the railroads had pulled back their offer. It was in the process of being executed, the contract and when I inquired about it, it was true. The railroad had pulled back their offer and reclassified my product as a PIH which is poison by inhalation and instead of a five-year contract, the new offer was a six-month contract with a 220 percent increase on the original rate offered and likewise, the fuel surcharge was increased by 220 percent.

Now, the characteristics of moving this shipment had no bearing on the cost of fuel. It was still a 58,000 pound tank car hauling 180,000 pounds of a liquid commodity and yet, due to this change, all things being equal in today's market, that would have added an additional $150,000 per year over and above the original fuel surcharge.

Now, is this fair? Absolutely not.

The other situation I would like to talk about is that I can ask for a rate today, today and I will be given say a rate of $3,000 per car plus fuel surcharge. But, the fuel surcharge is based on a 2002 index and I have to think and I do believe that in the railroad's initial rate offer to me, that they take into consideration their current costs. They might be lagging behind a little bit, but I sincerely doubt that it's four years and if that's the case, thank God, Degussa isn't behind four years on my paycheck.

One of the key bench marks used today is the revenue to variable cost analysis and the STB places the threshold for rate reasonableness at 180 percent over the railroad's variable cost. Due to the great fluctuation in this variable cost as it is today, I'm wondering if the fuel surcharge is flying under the radar.

It was mentioned before. Is the fuel

surcharge a rate or a practice? And it could be argued both ways in several different ways depending on the situation and the interpretation.

For example, if a fuel surcharge can be negotiated, to me, that's a rate. If a fuel surcharge is applied based on a given scale across all commodities, that's a practice and again, it could be argued by different people different ways depending on the situation and the interpretation.

In speaking to you as an individual shipper today, I am not here seeking restitution. I say let the past stay in the past. I railroads for years have been deemed revenue inadequate and with the prosperous economy over the last two years and the record volumes that the railroads are handling, capacity issues, dwell times have been a problem for shippers as well as railroads.

With the increased revenues that the railroads have been receiving over the last two years, I think that this is a good thing regardless of how they got it because they've announced collectively $8 billion in infrastructure improvements which include double and triple tracking, main corridors, expanding yards, adding locomotives, hiring trainmen and crews.

In today's economy with the congestion both in the intermodal business and carload business because even though they're two modes, they share the same tracks. I think this is a good thing and it benefits the shippers in the long run.

However, moving forward, I think there must be a change in the way the railroads are calculating their fuel surcharges. Fuel surcharges are rampant. The fuel costs themselves are extremely high and I don't think they're going any higher. All the reports I've seen, they're not going any lower either.

So, I hereby request that the Surface Transportation Board investigate the method and calculation by which the railroads are applying fuel surcharges. I personally commend those railroads who are attempting and I say attempting to implement a mileage-based fuel surcharge based on a fair scale. It's a first step towards a change that is long overdue.

And I also want to commend the Surface Transportation Board for allowing this hearing to bring this issue forward. Thank you very much.

CHAIRMAN BUTTREY: Thank you very much. Mr. Conway.

MR. CONWAY: Thank you, Chairman Buttrey and to Vice Chairman Mulvey.

My name is James Conway. I am Vice President of Sales and Marketing for Griffin Industries of Cold Spring, Kentucky.

Griffin Industries and this speaker would like to thank the Board for holding what we consider to be very important hearings on a very important topic and we'd also like to thank you for the opportunity to address the Board this afternoon in this session.

Griffin Industries is a 63-year-old family-owned company with 23 plants located in the southeast United States. By today's standards at least at this meeting, we would be considered a small company, but this subject is important to our owners and to our 1500 employees.

We process agricultural waste products into usable commodities such as fats, oils and dairy-feed ingredients. Until recently, we operated a fleet of over 500 tank, box and hopper-bottom cars to assist us in the delivery of our finished products.

Recently, we've had to decrease the size of our fleet by over 10 percent because of increasing cost of delivery by rail providers. It has, in fact, caused us to change the people to whom we do business with and in some cases, have even had to lose customers of a longstanding nature.

Now, we had earlier submitted our written testimony and it is not my intent today to repeat the entirety of that document, but I would like to address what I think are some important issues that are really pertinent to the fuel surcharge.

As energy costs continue to change the landscape of American business, one area that has been especially hard hit by those higher energy costs is agribusiness. Basic commodities which represent the vast majority of agribusiness are traditionally very inelastic to price changes. Many times increased costs are absorbed by the producer rather than being passed through that maybe many other manufactured products can do. In fact, we sell on a delivered basis and we get all we can get, but we then absorb all increased costs.

Now, our company has had a longstanding partnership with many of the class one railroads in this country. We rely on their service and certainly we respect their right to earn a fair and reasonable profit for the service they provide, but we are also aware that they operate at a somewhat different competitive environment than many companies do.

As a customer, Griffin does not have the ability to change rail suppliers at its individual plant locations. We are locked in to the road that services that particular area and under that circumstance, it is imperative that regulations exist for the fair treatment of unusual cost events.

Now, with particular reference to the current practice of adding fuel surcharges to the base rates, I have four specific concerns that I'd like to express to the Board and I'd like to take just a few moments to expand on each of them.

First of all, we have been subjected to significant base-rate increases over each of the past few years. In fact, in the written testimony I submitted earlier, I cited that our average base rate went up 17½ percent in 2005 versus 2004 and these were on the heels of substantial increases in base rates both in '04 and '03.

Now, in all cases, these rate increases utilized the RCAF to calculate what those should be and as has been clearly demonstrated and testified earlier today, in our opinion, RCAF does, in fact, include the increased cost of fuel as part of its adjustment factor. In very simple terms, the increased fuel costs have already been factored into the base rates before any surcharge is added.

Number two, we do object to the fact that the fuel surcharge is calculated on the total of the base rate. In other words, the surcharge is calculated on that portion of the base rate that is designed to cover such things as labor, depreciation and other cost factors. All of this even though the percent of the surcharge is calculated on the actual increase in fuel. If one accepts the need for a fuel surcharge, it should not be applied to the entirety of the base rate.

Number three, that surcharges that are used today are based on the price of number two diesel fuel that was established in the 1990s and on the arbitrary rate of $23 per barrel of crude oil. I would think that none of us would say that either of these two barometers are really relevant in today's economics. They are history.

This is especially true in consideration of the earlier contention that these increases had already been factored into the base rates. The railroad's contention that surcharges were only meant to be applicable for those temporary times that fuel costs are excessive is no longer applicable in today's real world economics. Higher fuel costs are a fact of life and have already been factored in to most base rates as I can determine and should no longer be a vehicle for revenue enhancement.

In view of these objections, if one is to accept the need for some type of increased fuel cost adjustment and as I said earlier we accept that fact, it should only be applied to the increases in true fuel costs since the last contract or the last tariff rate has been established. This would allow for true fuel cost increases relative to a specific rate and we implore the Board to consider this as a specific recommendation in future handling of fuel surcharges after recent or most recent base-rate changes have occurred.

Mr. Chairman, I would again like to thank the Board for giving Griffin Industries the opportunity to present our side of this important issue.

Please understand that we do not seek special treatment nor do we expect the nation's railroads to subsidize our business. We do ask that increased fuel costs be handled in a fair and reasonable manner, that if surcharges are truly needed that they be transparent, open and market driven, maybe you've heard that before today, and not used to exploit a captive customer's base that rely on the service and the function of these companies.

We look forward to a fair and reasonable action by this Board in this important issue.

Thank you for your time.

CHAIRMAN BUTTREY: Thank you very much, sir.

MR. WEISEL: Mr. Chairman, Mr. Vice Chairman, I wish I could sit here and say I agree with all my colleagues to the right, but I'll go through my process.

I'm from Idaho and I'm glad there's other people from Idaho, Montana and Eastern Washington. Hopefully, there's nothing wrong with the water out there. So, we're just trying to get through a lot of processes.

I'm Dave Weisel. I'm Director of Distribution for Potlatch Forest Products.

I'll give you a little bit of history. Potlatch celebrated their 100 years in 2003 and we're a forest products, lumber, particle board, paper, consumer products company and we got plants obviously around the 1.5 million acre trees in Arkansas, Idaho and Minnesota.

We have fuel surcharges in barges, motor carriers, ocean carriers that we use as well as rafts. So, it's not that we're against fuel surcharges. We have them and we understand that the carriers have to get their compensation for out of pocket cost, but doing it on applying the surcharges on the freight rate rather than seeking payment of the increase in the price paid for the consumed fuel, we believe is over compensating and an unreasonable practice.

And Potlatch is convinced that the surcharges that they have no more than reimburse the railroads for higher fuel costs they are incurring and they are not, in fact, establishing a profit center and we have seen nothing from the railroads as data to show us that the fuel surcharges are reasonable or explains why there should be such a wide disparity in the surcharges they are assessing particularly when a lot of them are pegged on the West Texas Intermediate Crude.

And you have a lot of formulas that recognize that the Surface Transportation Board is going to have a very difficult job in coming up with a reasonable, transparent type of program that we can all sit down and figure out, but I -- however, I would say I've got a pretty difficult job or these companies do of explaining this to our senior management.

I mean to give you a perfect example of something that transpired not too long ago, they said well, Dave, what are some of these guys pegging it on and I said well, West Texas Intermediate Crude. Well, some of them who even alluded that today it's such volatility that you can't budget for it. It does nothing to explain what's consumed. It does nothing to explain what's reasonable. It does nothing to explain where you're going in the future.

So, I do say the BNSF and their mileage program was a good attempt to get it on something that we all recognize. As somebody explained here this morning, you can recognize a car going a thousand miles is going to consume more than a car going 500 miles. So, you can explain that, but explaining some of this is pretty difficult.

If you take the motor carrier as an

example and I understand that's not rail, but you can take a motor carrier and you take the current fuel price and the base fuel price and the divide the result by the average miles per gallon efficiency for a truck. This results in a close approximation of the additional expense. The truck transportation actually incurs due to the increased fuel cost.

For example, where you can relate to, five/six miles per gallon increase in fuel costs for a truck that averages six miles per gallon or results in one cent per mile surcharge. You can relate to that.

And this is the reason we're looking at a cost-based fuel program that can be applied to all railroads. That way, we know what we're paying for. We know what's reasonable and we can track back pending the indexes and the data is relevant where we're going.

I did give you a handout. I'll just take a short moment of explaining what that is. We are not presently on the BNSF mileage program. So, that's the first thing I got to explain, but if you took these movements Prescott to Dallas, the current rail program under the current fuel surcharges at 223 miles, we'd be paying $347 in fuel surcharge and you can equate that to a thousand board feet per car and a thousand board feet per car of fuel surcharge.

If you take longer miles, Lewiston to Chicago of 1743 miles, you're presently paying $602 or $622.

If you took the BNSF mileage program for the same 1743 miles, you're paying $575 fuel surcharge. If you take the bottom one -- next to the bottom one, Gwinn, Michigan to Mobile, Alabama of 1220 miles, you're paying $394 under the present program. Under the BNSF program, you're paying $403 fuel surcharge.

Under a Rule 11, Lewiston to Kingston, Pennsylvania for a 2413 mile movement, you're paying $1,093 and if you break that out portion-wise, BNSF portion, Lewiston to Chicago, 1743 miles, you're paying $622 and the NS portion for lesser miles from Chicago to beyond of 670 miles, you're paying $471. The total BNSF mileage program for 2413 miles is $796 and if you take what the -- even the railroads are looking at this thing.

And I know it's in a Wall Street Journal article, but if you allow me to read this, it was in the May 8th Wall Street Journal and it says "At last, there's a way to get 410 miles per gallon and at Norfolk Southern, we're conscientious at the pump. We're always working to increase capacity while using less fuel. From improved infrastructure and shorter miles to on-board computers, we are able to accomplish an efficiency unimaginable just a few years ago. Today, we can move a ton of freight an average of 410 miles on just one gallon of diesel fuel. Mileage that keeps America economy strong.''

And I would have to say that, you know, we just have to take a reasonable and transparent and willing to work with the Board on anything that we need to work on to be able to explain ourselves at the end of the day.

Thank you, Mr. Chairman, Vice Chairman.

CHAIRMAN BUTTREY: Thanks to all of you for your testimony.

The carriers are required under SEC rules to file a great deal of data concerning the internal workings of the individual companies and there's been a lot made here about the issue of transparency.

What is it that you would expect to get on this transparency issue from the carrier that's not already available in their SEC files? That they would be able to let out into the public domain so to speak without being too proprietary.

MR. WEISEL: Well, I think there are elements of fuel or data of fuel that they submit already to the STB and so, I guess what we'd like to see is we can equate miles to miles, but, you know, and you can even do test programs of figuring out okay, are we compensating. Sort of like we do intra. The motor carriers come back to us and say, you know, we got to adjust the miles per gallon because we're not getting that and they can prove that to us on the trucks themselves. We give them that additional increase.

So, it's a data exchange of reasonableness and you can equate it back to something that you can take to your upper management and say well, I'm changing from six miles per gallon to five and a half miles per gallon because they've proved to me that's what they're getting.

So, I guess I would say I'm not smart enough to know what data's out there, but there must be data out there because this article. Obviously, I don't know where they -- that's marketing grant it, but there must be data available to know what you can move a ton of freight, you know, a mile.

CHAIRMAN BUTTREY: Anyone else?

MR. LOFTUS: Mr. Chairman, I think there is one more member of this panel that hasn't spoken yet.

MR. POCSIK: Total Petrochemicals, sir.

MR. LOFTUS: We can come up after these people are finished if you like or we can do it now. Whatever you like, Mr. Chairman.

CHAIRMAN BUTTREY: I'm sorry. You weren't sitting up at the table there. You probably need to get your testimony in the record right away here before we proceed further with questions.

I apologize for overlooking you.

MR. LOFTUS: That's all right.

CHAIRMAN BUTTREY: I'm sorry.

MR. POCSIK: There's a lot of interest in this topic for sure.

CHAIRMAN BUTTREY: You may proceed.

MR. POCSIK: Good afternoon, Chairman Buttrey and Vice Chairman Mulvey. I appreciate the opportunity to appear before you.

My name is Steve Pocsik and I'm Vice President of Supply Chain for Total Petrochemicals USA, Inc. or as we refer to it, TPI.

With me is our counsel, Michael McBride, who will address legal issues with respect to your authority over fuel surcharges.

I should start by saying that TPI is owned by the fourth largest oil company in the world, Total SA.

TPI is a part of the Petrochemicals Branch at Total SA and we manufacture and sell petrochemicals and plastic.

Our concern with this important issue is primarily related to the four to five billion pounds of plastic pellets we produce each year and our reliance on the railroads to transport our product throughout North America.

Now, although TPI is owned by an oil company, the Petrochemicals Branch is operated independently and is expected to stand on its own as a profitable financial venture. It not the intention of Total SA to subsidize its different divisions and, in fact, being focused on financial performance, Total SA is not required to own a petrochemical business in order to be profitable. One can validate this by looking at some competing oil companies who have chosen to spin off their petrochemical divisions. Two examples include BP which spun off its petrochemical business into what is now known as Ineos and Shell which spun off part of its petrochemical business into Basell.

Understanding that perspective, I hope you understand that as a major consumer of energy, energy which is not subsidized, we at TPI do understand what rising fuel costs mean to the bottom line. Fuel is as much a cost to TPI as it is the railroads.

I wish I could say that the plastics industry has the market power that the railroads have. If we did, then perhaps we could pass on to our customers the rising cost of fuel in the form of a fuel surcharge.

We're making a commodity, plastic pellets. Being in an intensely competitive business and fully subject to the anti-trust laws of the United States, my industry has to fight rising fuel costs not with unilaterally imposed fuel surcharges, but with improvements in efficiency.

Having said that, we can understand the basis for a fuel surcharge and since it is being imposed unilaterally and with discipline by the railroads, we have to accept the reality of fuel surcharges.

What we don't understand is the logic that is applied to the calculation method and the lack of transparency and, therefore, understanding as to whether or not these fuel surcharges are simply covering increases in actual fuel costs or whether the fuel surcharges are padding the pockets of the railroads with additional profits.

For us at TPI, the issue at hand is simple. We ship more than 20,000 hopper cars a year by rail. The rail mode is essential to us. At origin, one-third of our business is captive to a single railroad and at destination, more than half are captive to a single railroad and I point this out because current fuel surcharges as we've heard all morning are based on percentage of the rate that we've had and we all know that captive shippers pay anywhere from two to four times what shippers who have choice pay.

So, calculating the fuel surcharge as a function of the base rate means that for equivalent routes our captive ones pay two to four times as much as those routes that are competitively served. This pricing methodology is illogical and unfair.

The rates we pay in our current agreements have embedded in them the cost of fuel at some price. We know that is true or railroads would have been sharing fuel surcharges from the beginning. Instead, they began to impose surcharges as fuel prices began to rapidly increase over the last few years.

Our question is this. Are railroad fuel surcharges designed to recover the cost increase relative to the base price or the entire cost of fuel?

We are quite confident based on Wall Street reports that some double dipping is occurring. We are unsure of the extent to which this may be occurring specific to TPI due to the lack of transparency in reporting from the railroads.

It's unclear as to how the fuel surcharge as collected relates to the fuel that is consumed on our routes. By definition though, a fuel surcharge is a function of the rate and TPI's rates have less to do with mileage and more to do with whether routes are closed to a single railroad or competitively served. We can be certain that TPI is paying more than its share for the cost of fuel.

Only if a fuel surcharge is based on mileage or other proximity for actual fuel costs incurred could the methodology be fair.

As a shipper, what do I think is fair? We expect any fuel surcharge to be based on fuel consumption. More specifically, a fuel surcharge should be based on the actual fuel that is consumed for the ton miles related to our traffic. That means it should not be based on West Texas Intermediate or even highway diesel costs.

Moreover, we expect it to be based on unexpected price increases relative to the base price of fuel that's in the current rate structure. If the price of fuel decreases below the base and we're using a fuel surcharge methodology, we should get a credit.

In summary, we expect the fuel surcharges to be revenue neutral, to be based on fuel consumption for our specific routes and we expect open and transparent reporting of the accounting related to fuel surcharges.

Thank you very much for this opportunity to appear before you.

MR. MCBRIDE: Mr. Chairman, Mr. Vice Chairman, members of the staff, I am Michael McBride.

Let me begin and if I don't conclude within the time allotted on this panel, I am on the next panel and I'll complete the legal argument on the next panel.

In any event, I want to begin by saying that the question is not whether the railroads are fully recovering their costs through their fuel surcharges. That seemingly has been the question that some people have posed today.

The question ought to be whether the railroads are recovering all of their fuel costs.

Total is in favor of the railroads being able to recover all of their costs, but they do recover fuel costs already in their base rates as Mr. Pocsik has just indicated and through RCAF or other indexed adjustments. So, the question ought to be in addition, thereto, whether they are over recovering for their fuel costs by imposing fuel surcharges as well.

Now, this is not just a semantic dispute because it goes to the heart of your authority. It is not as if the railroads say these are rates and the shippers say these are practices and what's a fellow to do.

Rather the fact is that the railroads say that they charge rates and the railroads then say and we charge fuel surcharges. They, in fact, charge fuel surcharges sometimes in separate invoices or at least as a separate line item on the same invoice.

Therefore, this is an admission against interest that a fuel surcharge is not a rate and as Mr. Loftus already indicated by admission through filings with this Board, Norfolk Southern has called surcharges rules for practices.

Therefore, by definition, the limitations on your authority over rates do not apply to separate charges that they call something other than a rate. This disposes of the Union Pacific versus ICC case cited in your notice. I should know. I argued that case on the side of the Board. That case was a challenge to rates. We alleged market dominance. The ICC did not make a finding of market dominance and all the court held was the ICC had to find market dominance when rates were being challenged. That is the extent of the holding in that case and it has nothing, therefore, to do with fuel surcharges.

We did not indicate -- understand that the Board wanted to adjudicate now whether the exact level of any surcharge was unreasonable and Vice Chairman Mulvey, I do concede the question is whether it is reasonable or unreasonable.

But, we have proffered some evidence, some is attached to the Edison Electric Institute filing you'll be hearing about on the next panel. Others have pointed to a variety of Wall Street reports. There is plenty of evidence that the railroads are over recovering for their fuel costs.

I will be happy to provide additional Wall Street reports if you want them and need them, but I would want to observe that the Norfolk Southern advertisement that the gentleman just read to you from this Monday's Wall Street Journal demonstrates that by the railroad's admission, they are achieving great gains in railroad fuel efficiency and those are not reflected in any fuel surcharge mechanism that the railroads are imposing. Not one despite the differences in the railroad's fuel surcharge mechanisms.

There is a simple solution. If we're all grasping for how to solve the problem, the Board publishes the rail cost adjustment factor with productivity. That registers efficiency gains. As Mr. Crowley indicated, it's based on forecast prices. It's not a lagged index. It's a forecast index. If we want to return to first principles, you ought to say it is presumably reasonable to use the RCAF to adjust rates. Everything else may be subject to a complaint filed with the Board.

Thank you.

CHAIRMAN BUTTREY: Did that get everybody on this panel? I don't want to make the same mistake in the same hearing.

VICE CHAIRMAN MULVEY: I have one more here, but I guess --

CHAIRMAN BUTTREY: You what?

VICE CHAIRMAN MULVEY: I have one more testimony here, but --

CHAIRMAN BUTTREY: Do you have any questions you'd like to --

VICE CHAIRMAN MULVEY: Oh, yes, sure. I

have a follow up.

CHAIRMAN BUTTREY: Go ahead.

VICE CHAIRMAN MULVEY: Mr. McBride, I'll start with you.

One of the things we heard is that if indeed the fuel surcharge is a practice and it's deceptive because it's not really tied to the price of fuel, couldn't the railroads just turn around and say okay, we're going to call it our rate.'' We're going to increase the rates by X amount and that's the end of it.

MR. MCBRIDE: Well, there's been an announcement by one railroad that that's, in fact, what it's going to do. As somebody suggested earlier, that may be a function of the fact that you held this hearing and the shippers will have to deal with that if, in fact, that's what happens on July 1. That's Norfolk Southern as I think you know.

But, I would observe to you that your concern about the railroads raising adequate revenues to pay for the infrastructure that they need which you and I have discussed more than once and which concern you and I share is not in anyway adversely affected by any action you might take on fuel surcharges. Because since 1980, there has been precious little limitation on railroad rate increases as we all know and if the railroads want to take rate increases and then face the possibility of a complaint or contractual action if there's a contractual limitation on that rate, then so be it. But, at least things would then be transparent and out in the open as to what they're doing.

But, there is no limitation on a railroad's ability to raise revenue. What the shippers are objecting to is that they have a rate whether it's agreed upon or otherwise and then the railroad says oh, and we're not recovering all of our fuel and so, we're going to surcharge for it separately and the shipper says well, show me you're not recovering all your fuel cost and the railroad says no and you've heard that over and over again and that's the problem and there is only one entity in America that can do anything about it and that's you.

VICE CHAIRMAN MULVEY: We need the data to do that.

MR. MCBRIDE: Absolutely, you can't regulate intelligently without the data.

CHAIRMAN BUTTREY: The article that I read about Norfolk Southern was a little confusing to me about how this rate would kick in. On first blush anyway, it would appear that there would be an inclusion of part of the fuel cost increase in the rate. Then there would be -- at some point-- a new fuel surcharge that would then kick in at a much lower percentage. So, it's a little bit of both. It's not just one or the other.

MR. MCBRIDE: That is true, but there's some curious things about it, too and we might hear more from them later because I obviously don't speak for them and I don't know with certainty how they're going to do it even. But, the clients are confused. I can tell you that.

But, here's what we seem to know. Norfolk Southern has said that the current surcharge was based on some much lower number, 23, 25, $28 a barrel whatever it was. Fuel prices have now raised them to a much higher level as we all know.

Therefore, they say we're going to reset the rates at the $64 per barrel price, but the curious thing was that when they said that crude oil prices were much higher than $64 a barrel. So, where did $64 come from.

One of my clients suggested that it must have been the number they had in their budget, but there's no relationship to any actual cost of fuel at the time they did that and they've not provided any forecast that oil prices are going to be at $64 on July 1.

So, we start from a number that seems arbitrary and then secondly, they say they're going to raise rates, and the concern that a lot of people have is does that mean then that that becomes a floor.

So, that the concerns you've heard today about if fuel should go back down to say $40 to $50 a barrel, there won't be any corresponding reduction, means that it becomes a one-way mechanism if you have it and this agency and its predecessor have had experience with that.

When the RCAF started to go down in the mid-'80s, the agency ruled that rates should go down accordingly, that adjustment mechanisms should be used to recover costs and not become profit centers and so, we had some concerns about how the NS rate mechanism's going to work.

But, we have at least this much assurance, Mr. Chairman, that there may be some people who get an approved outcome from it because Norfolk Southern has been trying to surcharge on top of contractual rates that have adjustment for the RCAF in them. If they're going to at least try to raise rates that they have a right to raise let's assume, at least, they won't be trying to surcharge one hopes rates that are already being adjusted for fuel.

So, it may be something of a mixed bag I'll concede that we have some very great concerns about and I think the arbitrariness of using something other than off-highway diesel using West Texas Intermediate or on-highway diesel which they don't burn instead of off-highway diesel which they do burn and then picking some arbitrary number like $64 a barrel and using that as a floor perhaps, all lead to a lot of concerns in the shipping community that this whole fuel surcharge program is becoming a profit center and that we object to.

VICE CHAIRMAN MULVEY: The NS change may be similar to the BNSF change for the grain shipment and falls under the category be careful what you wish for. You may just get it.

With regard to Total, you were talking about the fact that between competitive and noncompetitive chemical traffic, obviously, the rates are different and, therefore, the fuel surcharges are different. Do you have any specific examples you can provide the Board as to whereas the movement and the weights, et cetera are roughly the same be it the fuel surcharge varies a lot because of the differences in the rates?

MR. POCSIK: Yes, in fact, we included that in our written testimony and if you would like more examples, we can provide more. We'd be pleased to do that.

VICE CHAIRMAN MULVEY: Thank you.

SPEAKER: I handed out several copies of the written testimony.

VICE CHAIRMAN MULVEY: Okay.

MR. POCSIK: We submitted separate written testimony.

VICE CHAIRMAN MULVEY: Thank you.

SPEAKER: Let me put it in the record.

VICE CHAIRMAN MULVEY: Thank you.

MR. POCSIK: Would you like more examples?

VICE CHAIRMAN MULVEY: No, I haven't looked at this one yet. I was looking at Mr. McBride's testimony. So, we did read most of this, but it was a lot to read I'll tell you.

Let me see. Mr. Heller, when you were calculating the fuel surcharges, how did you calculate them, the gross fuel surcharges? Were you doing the revenue calculations for the gross fuel surcharges? I mean there was some criticisms of the way they were done by a consultant for Escalation Incorporated in the sense that they were multiplying the fuel surcharges across all the traffic and not just for the traffic that pays them.

Did you do the same thing or were you more traffic specific in your estimates?

MR. HELLER: I was very traffic specific. The way I did this was to do an individual move and do the calculation relative to an individual move. So, I wasn't trying to presume that the railroads were, in fact, applying the surcharges across all their traffic.

The purpose of this was to illustrate. I just understood the question to be from an individual shipment. What would the effect of the revenue fuel surcharges be?

VICE CHAIRMAN MULVEY: Graniterock, you said you’re a captive shipper. You say that the railroads are engaged in discriminatory pricing, but the railroads are allowed to engage in price discrimination or random pricing. Isn't that so? So, why shouldn't they be allowed to differentially price the fuel surcharge if they can differentially price the traffic in general?

MR. SLAVIN: Well, you know, we feel that's basically just unfair. Whether they are allowed to do so or not, it's, you know, it ought to be fair. It ought to be out in the open and --

VICE CHAIRMAN MULVEY: You said yes, it's not a rate? Because it's a practice not a price. It's not a rate.

MR. SLAVIN: We believe it's a practice.

VICE CHAIRMAN MULVEY: Okay. I have a question for the Arkansas Electric Company. What percent of the fuel surcharge increase is passed on ? How much does that affect your rates to your final customers? The fuel surcharge, as you say, costs you several millions of dollars, but in terms of the impact on the rate to the final electric consumers, how much is that?

MR. SHARP: Any increase we have in our fuel costs as a electric utility that's regulated in the state of Arkansas, that additional cost is passed on to our members.

VICE CHAIRMAN MULVEY: Um-hum.

MR. SHARP: So, you know, they pay every penny of it.

VICE CHAIRMAN MULVEY: But, how much is it to the final consumer? I mean sometimes this comes down to pennies a month for individual consumers.

MR. SHARP: Oh, as a percentage?

VICE CHAIRMAN MULVEY: Yes.

MR. SHARP: I can get that. I didn't calculate it as a percentage.

VICE CHAIRMAN MULVEY: Okay. You noted that the fuel surcharge rate on coal was about 5 percent higher than on carload traffic, but wouldn't that be due to the fact that coal would be heavier and therefore, because of that, it might be more fuel intensive than carload traffic?

MR. SHARP: Well, there are quite a few differences between the way, as I understand it, like I say, we don't ship any carload grain traffic, but we are involved in a lot of coal and there are a lot of differences. There again, in the shipment of this coal, these are all unit trains that are kept whole as a unit. Typically, 135 cars for our use.

VICE CHAIRMAN MULVEY: Yes.

MR. SHARP: All of our coal comes from the Powder River Basin. Comes to the power plants in

Arkansas and I think the cars go straight back. So, you don't get this adding cars on, taking cars off and so forth. That unit train stays intact from Wyoming to Arkansas and back.

And from Wyoming to Arkansas, the loaded trains are coming in that direction. The elevations up in Wyoming are about 5,000 feet. In Arkansas, it's about 300 feet. So, you're going downhill. You're going downhill with loads and you're going uphill with the empties always, every trip and that saves fuel. I mean there's a big difference between just coasting a train downhill.

Now, obviously, there are areas where they got to go uphill and downhill, but the overall difference is downhill. So, it's going to take less energy.

Where a lot of your grain movements are east/west in nature and you don't see such a big difference in the elevation.

VICE CHAIRMAN MULVEY: That may explain some of the rate differences.

MR. SHARP: It could.

MR. LOFTUS: Vice Chairman Mulvey --

VICE CHAIRMAN MULVEY: Yes.

MR. LOFTUS: -- if I may, I'm on this panel. I just walked --

VICE CHAIRMAN MULVEY: I see.

MR. LOFTUS: Following Jim.

VICE CHAIRMAN MULVEY: He apologized for that.

MR. LOFTUS: If the thrust of your question, Vice Chairman Mulvey, is isn't there reason to believe that notwithstanding the differences the fuel surcharge on the coal traffic may be reasonably related to the incremental fuel cost, the answer is clearly no and that's been demonstrated in Mr. Heller's testimony, in the testimony of others and, in fact, although I haven't seen all the railroad statements, I'm not aware of any railroad suggesting that the fuel surcharge revenues are reasonably related to their increased costs for fuel on a movement-by-movement basis.

So, you know, and while I'm here, you know, you should disallow something that is claimed to be a fuel cost surcharge if it's not and the fact that as you've pointed out in this environment, the railroads have the pricing power to turn around and increase the rates anyway. Maybe so, but then you know what you're dealing with. You're dealing with a profit margin increase as such and not under the pretext of a fuel cost recovery mechanism.

VICE CHAIRMAN MULVEY: As long as you're up there, do you want to say a few words also about the issue of whether or not this is a rate increase as opposed to a non-rate factor, a practice rather than a price?

MR. LOFTUS: I would. We clearly believe that the fuel surcharge mechanisms are not rates as that term is used in the statute and that they are a practice and as we noted when we spoke earlier, at least one railroad has so acknowledged in writing before this Board and so, we don't believe that this falls under your maximum rate jurisdiction. It falls rather under your jurisdiction over unreasonable rules or practices which you have the authority to set aside.

VICE CHAIRMAN MULVEY: Both the Chairman and I have both expressed some concern about what's out there in terms of precedent. I know that you've cited a number of cases, but are there any specific court or Board or ICC cases you can point us to that might be illustrative for us?

MR. LOFTUS: We would agree with you that authority is sparse in the area. We have in our written comments in the argument section provided the authorities we thought were relevant and I can't say that I can without getting it out and reading you some or do much better than what we've done in writing.

VICE CHAIRMAN MULVEY: Okay. Thank you.

MR. LOFTUS: Thank you.

VICE CHAIRMAN MULVEY: A question for Degussa. Are you limited in your ability to pass on these surcharges? Is the demand for your product relatively elastic with regard to competitors or substitute products?

MS. ELHAKIM: We are limited. Depending on our product line and the market, we are very limited in what we can pass along.

VICE CHAIRMAN MULVEY: Is there any threat to your survival as a business or --

MS. ELHAKIM: To some business units, but I don't want to blame that solely on the fuel surcharge. There are so many other factors affecting the business not just the rail industry.

VICE CHAIRMAN MULVEY: Um-hum.

MS. ELHAKIM: But, again, to some smaller businesses, I do see a threat not just for survival of the entire business, but it's forcing us to selectively decide who we're going to supply based on costs and market and availability.

In some instances, some of our products, we just can't produce them at any sort of -- make sort of profit on them.

VICE CHAIRMAN MULVEY: Thank you.

MS. ELHAKIM: And I'd like to address one of the questions you had posed before about providing examples --

VICE CHAIRMAN MULVEY: Um-hum.

MS. ELHAKIM: --- of different commodities. In my written testimony, I've given exhibits from three railroads. And I do have other copies if you'd like them.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN BUTTREY: I don't think we have anything further for this panel. So, you're excused and we will take up the next panel.

The next panel for this afternoon is the panel of trade associations. We're expecting testimony from National Industrial Transportation League, the American Chemistry Council and from Edison Electric Institute.

Are there any other people on this panel that wish to testify? Anybody else want to be on this panel?

VICE CHAIRMAN MULVEY: Mr. McBride, are you coming back with the railroads also or are you --

CHAIRMAN BUTTREY: Mr. Ficker, are you ready to go?

MR. FICKER: Mr. Chairman, I have been ready to go from 9:00 this morning.

CHAIRMAN BUTTREY: We welcome this panel this afternoon. It looks like everybody in the audience is eager to hear what you have to say and so, we'd like to have you proceed.

MR. FICKER: Well, thank you, Mr. Chairman, Mr. Vice Chairman. It's a pleasure to be here as always. The Board is a great place to share ideas about the important world of transportation.

You know us and we know you. We've been with you before on this very subject and we'll talk about that briefly. We've put in our written comments and today we'd like to expand on those comments slightly and we have a Power Point presentation to do that.

And to begin our presentation, I'd like to introduce our first Vice Chairman of the League who will be my boss next year Curt Warfel from Eka Chemicals of Atlanta, Georgia.

Curt.

MR. WARFEL: Thank you, John.

Chairman Buttrey, Vice Chairman Mulvey, the NIT League has a number of key positions relative to fuel surcharges. First off, we agree that a fuel surcharge properly structured and properly administered is an appropriate method for recovering extraordinary and I'll say it again extraordinary increases in fuel cost. We believe that fuel surcharges which are based on freight cost, it says freight cost here, but really what we're saying is the amount of freight that's being paid creates significant inequities.

We believe that it's improper to rob from Peter to pay Paul and we firmly believe that the STB does have the authority oversee fuel surcharge programs.

Now, John's going to address each of these in a little more detail later on.

Now, while we do believe it is proper to use fuel surcharges to recover increased fuel cost, we ought to point out that there are at least two other means by which a carrier can recover fuel costs. Now, several carriers today have mentioned RCAF. Speakers have mentioned RCAF.

Perhaps more logically, a carrier could enter into shorter term contracts that enable them to recover the cost of fuel a little more quickly.

Now, the League thinks that a snapshot of a proper fuel surcharge program would contain these following elements. It would relate to the actual changes in fuel costs incurred to transport or ship the goods. It would not be revenue generating. It would recognize the differences in fuel costs for different types of rail service. Say, for example, from units running coal to merchandise traffic. It would use an index that accurately reflects a carrier's fuel costs and perhaps most importantly, it would reflect the true based fuel cost used to established a freight rate.

Now, on the other hand, what would an unreasonable fuel surcharge program look like? Well, it would be one that would charge customers -- some customers an excessive fuel surcharge to make up for not charging other customers a fuel surcharge period. It would be based on a percentage of the freight rate which as several speakers have already said today tends to create a significant inequity when looking at different commodity groups. It would use an index that tends to overcompensate the carrier for fuel cost changes and it would apply the same fuel surcharge rate on price even those issued today that would presumably already have the higher cost of fuel built in.

Well, John's going to talk a little bit about the past history with the League.

MR. FICKER: You all know that we have been with you on this subject for almost two years now. We've come to the Board in 2004, met with the former chairman and talked to him. Along with National Grain and Feed and several other associations, we produced a study and we produced a series of recommendations.

We determined that the best approach was the private sector approach and we agreed to meet with key rail officials which we did and then we met with the Board after that to advise the Board of the effect of those particular meetings.

When we met with rail carriers, we presented to each rail carrier our study and our proposal. We have a proposal and we'll again share that with you today which we believe is a fair, equitable and transparent proposal.

We would like to commend the BNSF, CN and CP to listening to the arguments that we made and the discussions we had about the unfairness of the current structure and taking some actions to address those things. We believe the actions were well intended and are moving in the right direction. We would probably like to see more.

We're disappointed, however, that the eastern carriers have chosen not to pay any attention to that.

Here is an example of some of the data that has been talked about today that shows over recovery. The green bar recognizes the increased fuel expense per car and the red bar is the actual fuel surcharge revenue per car and anyone can see that there's a significant over recovery out of rail carriers.

Also, it's been pointed out today, Vice Chairman Mulvey, you mentioned does anybody have specific rate examples. Well, here are some specific rate examples. This is the exact same ship, a boxcar, 150,000 pounds and the same origin, Eugene, Oregon to Chicago, Illinois, over the same route, BNSF. Four different commodities, grass seed, lumber, pulp and paper. Because of the rate, the grass seed fuel surcharge is $469 whereas the paper fuel surcharge is $849 which represents an 87 percent increase for the movement of the same product to the same origin from the same destination in exactly the same kind of car.

Now, Peter and Paul is an interesting theory that we've kind of espoused here and it's been talked about a little bit earlier today, but we'd like to elaborate on it if we could.

Some customers are not charged fuel surcharges and that's been clearly pointed out because they have contractual arrangements with railroads which preclude the application of fuel surcharges. That's all well and good. That was a commercial decision made by the parties, well, a long time ago.

And to charge Peter to pay for Paul, we think is wrong, unfair and unreasonable.

Differential pricing is permitted in rate making as Staggers clearly pointed out, but not in the application of fuel surcharges and carriers should be held accountable for the commercial choices and decisions that they've made and one shipper should not be required to make up for the difference in another shipper. The Board should not be a place where the carriers can come and say to you gee, we can't collect this because of a commercial arrangement that we by the way signed and we hope that you would make that up for us.

There is some significant gaps in the world of fuel surcharges, too and this has been pointed out today. One of the questions earlier to the panels was what data is needed. It's difficult to understand the data that's out there in the carrier's report.

Fuel can well be fuel that's used for moving auto cars and for trucks moving around hauling parts and people to support the rail operations as well as the fuel that's used to haul freight cars and what we're talking about here is the fuel that's used to haul freight cars. We agree with everyone else that hedging should not be a component of this discussion and there is virtually no data at all in the waybill sample that would allow you to really understand the fuel cost application that's in the approaches that the railroads take.

We believe clearly as Mike McBride pointed out earlier and I'm sure he let go again in a few minutes that the Board has clear jurisdiction in this area. This is clearly pointed out in the statute and ICC history is fairly clear on that subject.

And I'd like to ask Curt to kind of wrap things up.

MR. WARFEL: Basically, we feel there are two key actions which the Board should take.

One, you should order carriers to provide better and more complete fuel cost data and secondly, you should order each carrier to undertake a review of the fuel surcharge methodologies being used today, taking into account principles established in this hearing and further to have the carriers report back to the Board, the results of those findings within 90 days of the Board's order.

So, just to wrap things up here, I guess if I could pretty much summarize what all the shippers which you've heard from so far have asked for, I mean basically what we're asking for is fairness transparency.

The Board has asked earlier today for a recommended fuel surcharge methodology. John has indicated one is in our proposal. I have copies here if you need them.

And I guess I'd just like to wrap up by again saying thank you for the opportunity to appear before you and thank you for having this hearing. It's a very important issue.

CHAIRMAN BUTTREY: Thank you very much. Mr. McBride.

MR. MCBRIDE: Mr. Chairman, Mr. Vice Chairman, I am standing in for Chuck Linderman this afternoon who was summoned away to deal with the difficult coal supply situation that the industry is facing and which has been given the highest attention as you may be aware.

I also wanted to take a moment since I won't use the full ten minutes since I'll be speaking for both of us to say that I became aware during the hearing, Mr. Chairman, about the very sad news about one of your key staff members and I wanted to just say he's a friend and he is in our thoughts and prayers and I wish you would convey to his family the same sentiments that you did on behalf of the Board to them.

CHAIRMAN BUTTREY: Thank you.

MR. MCBRIDE: You're welcome.

Edison Electric Institute as I'm sure you know is the association of the investor-owned electric utility industry. Electric utilities as you've today actually have a higher percentage of their total cost in fuel than do the railroads. It would, therefore, be hypocritical to oppose cost recovery on the part of the railroads and obviously, we do not and like all the other shippers whether regulated or unregulated, no one wants to stand in the way of the railroads' being able to recover their costs.

That said, the railroads are in a unique situation. The utilities like other regulated companies have to answer to their regulators about what their actual fuel costs are and as you heard some explain to you already today, fuel costs are treated entirely separately from the underlying rates and are looked at separately by the regulatory bodies and no utility is ever allowed to recover more than its fuel costs in the course of those separate fuel proceedings.

We think that's not just fair. That's reasonable and that's the law and that ought to be the law here, too.

Now, the railroads also like to say if a contract ever works out in their favor which sometimes they do, contracts sometimes work out in one party's favor, sometimes in the other, that a deal is a deal and we think that's right. We think that's the law and so, if they're under recovering on their contracts, a deal is a deal and the rest of the shippers shouldn't have to pay for that.

There are even railroads that have come before the Board and informed the Board that demand exceeds capacity on certain lines. Well, unless they're being irrational and they're not, the only possible way that that could be true is if the rates are being held down because of contracts. So, that should not be the burden on the rest of the shipping community.

In any event, as for the law, I just want to supplement a few of the points that I made earlier for Total.

The statute is clear that if an unreasonable practice is involved instead of a rate, you do not have to find market dominance. Therefore, you would not have to proceed rate by rate making the kind of determinations that you do. You could take action of a more generic nature and I think that's what you're hearing the shipping community say to you uniformly. That some action of a uniform nature that is reasonable to the railroads and reasonable to the shippers.

Now, in terms of authority by the way, it may be interesting to know in addition to what I told you earlier that when Congress recodified the Interstate Commerce Act and the Interstate Commerce Commission Termination Act in 1995 it repealed a provision of the existing statute former Section 10707(a)(h) which read: "The authority of the Commission to determine and prescribe rules, classifications and practices may not be used directly or indirectly to limit the rates which carriers are otherwise authorized to establish under this subtitle."

It is not permissible to assume that Congress engaged in a futile act and therefore, you must presume that Congress intended something by repealing that prohibition and I submit that is consistent with the argument that I made previously that when railroads call surcharges something other than rates, when they charge separately for them, when they say their rules or practices and Congress has said to you you have authority to act without going through the market dominance and complex rate-making determination that otherwise constrains your authority, Congress did not constrain your authority with respect to rules and practices.

So, what we would have then if we were to proceed on the basis of some more agreed upon index such as your rail cost adjustment factor? Many of us have spent much of our careers getting that index just right. It started in 1977. It wasn't until 1992 that the courts finally blessed the RCAF as it exists today. It's got fuel in it. It's a forecasted index. It's got productivity in it. The railroads prepare the data and submit it to the Board. The data is out there for everyone to see.

No one has explained to me. In any of the railroad filings that I've seen, there is no explanation why the RCAF would not be a fair mechanism, a reasonable mechanism since you yourself publish it for determining a presumptively reasonable recovery of fuel costs and any other recovery of fuel costs should, therefore, be considered at least suspect and subject to challenge before you. Because by definition, it is not, therefore, an adjustment taken in accordance with the mechanism that you have determined as a Board and published quarterly as the proper mechanism under the statute for recovery of cost.

I think I'll conclude there and leave you the additional minutes that I otherwise would have taken, but I'd be happy to answer any of your questions of course.

CHAIRMAN BUTTREY: Thank you very much. Mr. Schick.

MR. SCHICK: Chairman Buttrey, Vice Chairman Mulvey, I'm Tom Schick. I'm with American Chemistry Council. We're also pleased to be here today to talk about this important matter.

ACC has also submitted as part of its filing in this docket the testimony of Tom O'Connor and Kim Hillenbrand from Snavely King, but they are on panel IV and it was deemed by the Board to leave them on panel IV. So, I look forward to their addressing some of the more technical matters later this afternoon.

ACC membership and we've had two members here testifying in an earlier panel today, but ACC's membership as a whole accounts for about 85 percent of the chemical products including plastic products that are produced in the United States.

Our members depend on the railroads in

this country for safe, secure, efficient transportation of about 170 million tons of traffic and provide more than $5 billion in annual revenue of the railroads. Chemicals are the second largest commodity carried by rail in the United States.

ACC's position on this docket is that indeed railroad fuel surcharges are not reasonable practices under Section 10702 part 2 and we ask the Board to exercise its authority and we have no doubt you have that authority to remedy the flaws in the way that the rail carriers have been calculating and applying those fuel surcharges.

Underlying all of this and I think we've heard a lot about it today is that a railroad's ability to engage in unreasonable practices is based on an absence of effective competition for much of the traffic that our members move by rail. Not all, but much of the traffic and some of our members have testified about that on a previous panel.

Sixty-three percent of the chemical manufacturing plants operated by our members, there's only one rail carrier. That kind of market power is enhanced beyond the plant when the destination is captive even if the origin point is not.

We ship products by all modes of transportation and in the other modes, of course, there are fuel surcharges, but those are subject to negotiation and they're subject to market forces. What we have here is in many instances an absolute inability to negotiate or a kind of take it or leave it as people have described it earlier in this application of fuel surcharges of the railroads.

As Mr. Pocsik said earlier, we've got costs for energy, too. Chemical manufacturing plastic resin production are very, very energy intensive. We'd like to be able to get that back in passing it along. I think there was a question to Ms. Elhakim. No, we cannot always pass every penny of it along. We'd like to, but we can't.

So, you have to keep in mind that you're dealing with a practice in an industry where there's a lack of competition between the service provider and the customer to begin with.

From our point of view, there are five

aspects of this. John, could you hit the next and final slide here?

This just summarizes the written testimony which we have submitted. I'll go over a couple of the highlights on that and then we can get on to questions.

First of all as many, many folks have already talked about, fuel surcharges as applied by the railroads are not based on the actual fuel consumption. ACC has no quarrel with the concept of fuel cost recovery, but it clearly has to be related to what the cost of fuel is. That should be related to something that has something to do with moving traffic like distance, weight of the shipment, gross tons, gross ton miles, tonnage, carloads, car miles, something like that. Maybe the grade, the uphill, the downhill as we talked about on the previous panel as well. But, it has to have to do with something that has something to do with costs.

Snavely King will address some of this on panel IV when they come up. They've looked at this closely at our request.

The second point on our list of five and I guess everybody's got either four or five points here today, the ones that put the slides up, is that it's inappropriate for a fuel surcharge to be linked to the freight rates. So much has been said about that. So much has been said about the components that go into freight rates. Whether it's non-fuel costs or whether it's other elements. Then I think I'm going to leave that one alone and turn to the third point.

The third point is that higher fuel costs are also being recovered by other means. We've got a good discussion today about the rail cost adjustment factor. We've had a discussion about contracts being renewed, about new tariffs being published or new prices being put out there and it is really stretching anyone's belief to think that these rates haven't changed since 2001 or haven't been encompassing at least some of the fuel surcharge.

So, we would say that a new freight rate shouldn't be subjected to a surcharge unless subsequent to that rate coming out there's another unanticipated increase in fuel cost and it should be triggered at that point and not cumulated up. No portion of a fuel cost should be recovered twice from any shipper.

Again, Snavely King, Mr. O'Connor will talk about that on the fourth panel, but we want to be sure that you understand aside from the calculations and recommendations he's made that as a matter of principle, we think this is incredibly important.

The fourth point on our list this is what NIT League referred to as robbing Peter to pay Paul. You shouldn't be having some shippers overcharged on fuel surcharges or applying a higher fuel surcharge to those shippers who are subject to it simply because commercial decisions leave other shippers immune from a fuel surcharge. Again, we're not quarreling with the concept of a fuel surcharge, but we don't quite see how captive customers or other customers should be asked to pay for a shortfall that's not -- has nothing to do with the traffic that they're asking to be moved.

The recovery of unanticipated, you know, we keep coming back to unanticipated, unanticipated fuel cost increases is an admirable objective for any company. We don't quarrel with that from the railroads, but it doesn't mean that it's guaranteed that they will recover let alone over recover the fuel surcharges.

The final point, and this is another one we've talked about a lot today, is transparency. We really need transparency and I think that this something which goes to the heart of what the STB can do under its supervision of the railroad industry. As someone said earlier, Mike, it might have been you, there is no other forum. Nobody else has the authority to look at these kinds of issues except for the STB.

So, what have we heard here and you'll see if you look at the testimony that we submitted and others, we have people analyzing filings to the Securities and Exchange Commission, but not quite getting all the way to where they need to go. We have people looking at the waybill sample, but, of course, the waybill sample doesn't really break out the fuel surcharge. We have people looking at the R1 that are submitted to the STB, but not quite being able to close the gap. We have shippers making examples or anecdotes or calculations or being asked to submit further ones. We're putting them up on the screen here, but that doesn't quite do it. We have people looking at financial analyst reports and what can the financial analyst put together to see what the effect of fuel surcharge is. We have people reading articles in the Wall Street Journal. We have all kinds of things going on here.

But, the one thing we don't have is we don't have a single central place where the data is collected, is collected in an authoritative manner from the railroads by the Government and it's put out there for everybody's use as it would be by a public service commission looking at a fuel surcharge for an electric power company.

I think it's incumbent on the Board, ACC thinks it's incumbent on the Board to create a set of transparent data and then to have that available to everybody so these things can be assessed. There's no one else who can do it.

So, in conclusion, yes, you have authority. There's no question you have authority. We ask you to remedy the problems in the railroad fuel surcharge practices. They differ from railroad to railroad, but I think you have authority to take a look at that and to fix that.

I look forward not only to panel IV where there will be some discussion of the details of this, but I'm also looking forward to the railroad panel to see what the railroads have to say about all of this.

Thank you.

CHAIRMAN BUTTREY: Thank you. Mr. McBride, I've listened very carefully to your comments, testimony. It sounded at one point during your comments that you think it would be a perfectly reasonable approach for the Board to just simply say we're not going to have fuel surcharges anymore. They're an unreasonable practice and we're just going to require-- let the railroads to put everything in the rate. Is that an accurate recapitulation of what you said?

MR. MCBRIDE: I think you could do that.

I don't think that's the only thing that is appropriate. There are other ways to deal with the problem, but there is an RCAF out there and so, if they're not taking RCAF increases, you could be saying at the same time that we think it would be far more reasonable, accurate and transparent for the railroads to take RCAF increases unless their contracts require something else and if they require something else, it's off the table and outside your jurisdiction anyway.

But, if you take the RCAF increases, those are presumptively reasonable and we won't hear anybody complain about them. If you take anything else, we're not going to tell you can't take a fuel surcharge, but what we are signaling is that we'll entertain complaints if the shippers can prove that the surcharges do, indeed double dip, over recover or otherwise inaccurately compensate the railroads for the fuel cost.

Because what you have in front of you, think about it this way, you have an RCAF that is based on railroad data that your staff scrubs and applies a productivity adjustment to and puts out for everyone to see every quarter and we can fight about it if we have to and we rarely do anymore because you've got it down to a science.

Nobody could say that about the fuel surcharges. We don't have that transparency. We don't have that data and they're not all the same and they're not even based on off-highway diesel. Not a single railroad that I know of uses as its surcharge the fuel that they use and you've heard about that this morning and I can assure you having represented the petroleum industry on this that when the ultra-low sulfur diesel for highway use comes in in the fall their costs are going to go up to make it, but, the railroads aren't going to be subject to that for the off-highway diesel for several more years, 2012 I believe it is.

So, almost by definition since they're using something other than what they burn, the fuel charges are at least suspect. They ought to be challengeable. I mean it's as if they're using the price of bananas. It's only a coincidence if what they're using to rely on for their fuel surcharges compensates them in an accurate manner for their fuel costs.

CHAIRMAN BUTTREY: Mr. Ficker, you look like you had something you might want to say.

MR. FICKER: Well, I think there's an important point that Mike just made in this. I'm not near as articulate as Mr. McBride and his fine legal talent that he displays here in front of this agency, but there's a couple of things that have gone on.

We, as you know, have sat with you and explained the proposals that we took. We believe the proper solution to this is for the railroads and the shippers to come down and work something out, but we've tried.

We spent a year and a half talking to the rail carriers, showing them our proposal and our proposal dealt with off-highway diesel price that's published every week by the same energy information agency that publishes the on-highway diesel and it's clearly much more aligned with the cost of the fuel that the railroads consume. So, we believe that's an appropriate approach as well.

We stand ready and willing to sit down and work with the railroads today, right now to come up with a more equitable, transparent, fair, reasonable approach to fuel surcharges. We don't object to the concept.

Most of the rates today from the majority of our members are market-based rates that are probably not subject to your jurisdiction because they've been exempted over the last many years. So, the reality that we're facing is the need for shippers to be able to say I can see how this cost happens. I can justify it for my organization and I accept it as it is.

Because there's no negotiation on fuel surcharges today. It's a take it or leave it thing. You want this -- you want to move your goods. Here's the price and oh, by the way, you will pay a fuel surcharge and we'll publish that arbitrarily without any discussion with you whatsoever.

CHAIRMAN BUTTREY: Any rebuttal?

MR. MCBRIDE: No rebuttal. I just want to say that if you think about it this way you might just put the question to the railroads very simply, how could it be unfair to you if we said that you can take RCAF increases and those would be presumptively reasonable, but that anything else is subject to challenge before the Board?

VICE CHAIRMAN MULVEY: Mr. Ficker, historically, fuel surcharges were allowed to be implemented carefully, infrequently, without constant change and only temporarily in response to emergencies. Which of these factors would you say are present today?

MR. FICKER: All of the above.

VICE CHAIRMAN MULVEY: All are present?

MR. FICKER: Many of the above are present. Vice Chairman Mulvey, would you go through that list again? Because you went through it pretty quick.

VICE CHAIRMAN MULVEY: Yes.

MR. FICKER: You've got it written down and I don't.

VICE CHAIRMAN MULVEY: Well, what I said

was historically, fuel surcharges were allowed --

MR. FICKER: Okay.

VICE CHAIRMAN MULVEY: -- to be implemented infrequently, carefully, without constant change and only temporarily in response to emergencies. Which of those characterize today's railroad fuel surcharge?

MR. FICKER: Everything but the first one. I think you said infrequently. There have been frequent. We've had them in place now since about 2001 and the study that we attached to our written testimony clearly points that out.

They should be allowed to exist to compensate for that aberration not the fuel costs and what gets mixed up in this dialogue, and I've seen it in written articles and in dialogue and in hallway conversation, is oh, we're not recovering our cost of fuel. That's not what a fuel surcharge is intended to do. It's intended to recover the extraordinary cost as we point out of fuel.

You have a rate structure. It's meant to recover your fuel costs and there isn't a railroad that I'm aware of that doesn't look at their cost structure when they're making rates as well as market conditions before they publish a rate for a user.

VICE CHAIRMAN MULVEY: It's been alleged that some firms pay no fuel surcharges at all because of their contracts, but it's also been indicated that some firms pay no fuel surcharges because the railroads feel they would lose the traffic if they levied fuel charges on them. This would be a very truck intermodal traffic. Do any of your members not pay fuel surcharges who don't have them precluded by contract?

MR. FICKER: I'm not aware of any, Vice Chairman. I can assume that that might exist, but from what I've been in contact with members for the last two years on this subject, very few members that I know of escape a fuel surcharge regardless of their transportation characteristics.

VICE CHAIRMAN MULVEY: And, Mr. Schick, is it true that high transportation rates are moving chemical industry jobs offshore, especially rail transportation rates?

MR. SCHICK: I would agree with the first part. High costs are moving chemical industry jobs offshore. I will not say to you that I can point to, with one exception, that I can point to it being caused by: There are many factors, labor costs, energy costs. Energy costs are a huge factor for the chemical industry and various other factors including rail cost is one of them. I can't say to you that it's because of rail costs alone or of rail surcharges alone, but there is no question.

I think Ms. Elhakim covered this when you asked a comparable question that was company specific to her and obviously, I'm not speaking for any one company, but it does grind down into the company and have to make decisions about what's going to be done.

There's an interaction here. Interestingly, I'm sitting next to Mike and he's representing the electric industry. There's a huge interaction here. When the fuel surcharge is applied to coal traffic, it drives up the cost of electricity. Electricity is a very, very large factor in chemical manufacturing. So, we're paying for it there as well.

That also forces utilities to burn more natural gas either because the cost of coal goes up or because of the unavailability of coal. In some cases, there have been shortfalls in the amount of coal delivered from the Powder River Basin. When the cost of gas is driven up, that drives up not only our electric cost, but it also drives up the cost of the gas that we use as fuel and particularly as well as in feed stocks.

So, I mean these fuel surcharges are hitting us in our chemical sector a couple of times over. Just the fuel surcharges themselves.

VICE CHAIRMAN MULVEY: Do you feel that the current RCAF formula is currently being used to recover all the extra cost of fuel to the railroads or is it partially recovering it and the railroads are trying to get the rest of it from the fuel surcharges or is the fuel surcharge almost purely a markup over the cost of --

MR. FICKER: It's hard to tell exactly how that plays out, Vice Chairman. One of the things that I think is important to point out and we point this out in our written testimony, the fuel surcharge approach began as a small increment. It began as a couple of percentage points and the ease of application was let's just apply it to the freight bill. Here's the freight bill. It's $1,000. We're going to charge you 1 percent more. You're going to pay $1,010 and it was pretty simple.

But, what's happened is those numbers have risen. This whole situation has just gotten out of control and out of hand.

The railroads could have very easily when the price of fuel started to hit 35 and 45 and $50 a barrel said hey, we see there's a problem here. We'll adjust this and I would bet a lot of money we wouldn't be having this hearing today because the issue would have been dealt with. They had that opportunity.

We took that opportunity with them to point this out and urge them to adjust accordingly, but they felt it wasn't in their best interest to do that and you have to ask them and I'm sure you will when they're here why they've done that.

So, the real issue is we have a situation that grew from a need. The need was left unchecked and it wasn't adjusted to deal with the times. The situation migrated forward and that's what we're urging as an agency to take care or to direct the carriers to work with us on solutions. Because I still believe, firmly believe, that working together with the rail industry we can provide a reasonable approach, transparent approach and a fair approach for everyone.

VICE CHAIRMAN MULVEY: We hope so, too. I have one final question and that is that you point out that the railroads did not act immediately when costs began to rise and then they began to institute the fuel surcharges and to some extent, the fact that the fuel surcharges are increasing more than the price of fuel has increased from the time they instituted it reflect to some extent that there's a catch up going on here. That they were trying to catch up some of the increase that took place before they instituted the surcharges.

MR. FICKER: That graph that we had shown earlier shows they're clearly over compensating --

VICE CHAIRMAN MULVEY: Overcompensating from the base, however, but they're trying to compensate beyond that.

MR. FICKER: Right. I think they've over compensated clearly from going backwards. Now, again, the whole question becomes are you recovering your costs of fuel or the extraordinary increase in the cost of fuel. A very, very important distinction and one I'm sure that you fully understand and fully appreciate and our goal here would be to overcome that recognizing that there's some because of the commercial decisions made by both parties that they're not going to recover that on and that's appropriate.

MR. MCBRIDE: Mr. Vice Chairman, in further response to your earlier question to Mr. Ficker about the way the index works, there are two aspects of this that we need to break apart so you'll understand. The answer to your question is as follows.

The RCAF by definition must recover the exact cost of the fuel that the railroads incur because it has the following feature. They forecast the fuel for the upcoming quarter as was previously explained to you and then on an after-the-fact basis, it builds in a forecast error adjustment that the Board applies to correct for any forecast errors two quarters hence.

So, on the fuel price itself, it works out over time to exactly recover for the fuel prices. There is, however, a separate aspect of the index that may require another look and that is that the index is periodically re-weighted and fuel is a portion of the railroad's total cost. There was a time where it may have been 5 or 6 or 7 percent. It grew to 10 percent I believe and it's probably higher now.

VICE CHAIRMAN MULVEY: It's 12 percent right now.

MR. MCBRIDE: Twelve percent and so, if the weights in the index are less than the 12 percent figure assuming that to be correct that you just provided --

VICE CHAIRMAN MULVEY: It's 20 percent right now. The railroads estimate their cost. It's 12 percent in the index.

MR. MCBRIDE: In the index. Well, then by definition, the index may need re-weighting. The agency has re-weighted periodically, but on arbitrary time schedules, two or five years since it's been in existence and it may be appropriate to consider a prompt re-weighting of the index so that fuel is not under recovered as a portion of the total cost.

And you heard Mr. Crowley explain you could then publish even monthly if you had any further concerns. It may be difficult to re-weight monthly, but in principle, you ought to be able to re-weight more frequently and I don't hear any principled objection to doing that.

VICE CHAIRMAN MULVEY: Thank you.

MR. SCHICK: Vice Chairman Mulvey, I just want to add that in terms of the RCAF I certainly agree with what Mike and what John have just said. We would agree with that completely.

In terms of this mismatch and I hope there's nobody left in this room who misunderstands the question of over, excuse me, not over, of recovering fuel costs versus recovering that incremental unanticipated fuel cost.

Our consultant will discuss with you the fact I think that over recovery was $900 million cumulatively to date and that's not even a complete number because of some of these data difficulties they ran into. There were other slides and graphs that were shown today.

So, this is a very important issue and going forward, it should be done with something like the RCAF.

I want to share with the Board one of the member company folks after looking at the draft of ACC's testimony. He said very nice testimony. He says all the points that we wanted to make, but where is the sentence asking for the refund of the overcharge and I said no. I said I had read the Board's order and this is not a rate case and we were not going to ask you to refund the money. We certainly do respect that.

On the other hand when you think about it -- and no matter how much the amount is and I know the railroads have infrastructure needs and we are very cognizant of that and we want them to be able to invest in their infrastructure because we are so dependent on them. On the other hand, I can't believe that they expected to fund their entire infrastructure or an important component of their infrastructure out of a fuel surcharge on an unanticipated event that might never have come to pass. I mean certainly they have other ways of making rates and other ways of obtaining revenue than to do it through this mechanism which has these flaws that we've talked about today.

Thank you.

VICE CHAIRMAN MULVEY: Thanks.

CHAIRMAN BUTTREY: Mr. McBride.

MR. MCBRIDE: Yes, sir.

CHAIRMAN BUTTREY: I don't want to get the cart before the horse here, but there was a suggestion made earlier in the testimony that if the Board decides it wants to take this record and take some kind of regulatory action, that that regulatory action should be cast in terms of a rulemaking proceeding under the APA. Do you have a position on that or do you have views on that that you would share with us?

MR. MCBRIDE: Well, if you were going to take action with respect to the RCAF, I think you would be obliged to do that because you do publish it and you publish it in accordance with regulations and so, you would have to issue a notice of proposed rulemaking to change those regulations.

If you were to issue a policy statement which you're permitted to do, of course, you could issue a policy statement without having to engage in a rulemaking proceeding.

I think the one thing you can't do is adjudicate today or on the state of this record somebody's actual rates or fuel surcharges. Those would have to be the subject of a separate proceeding.

It just depends on in the first two instances, however, how you choose to proceed and I think you have great latitude to proceed either in a rulemaking with respect to the RCAF or any other rules or to issue a policy statement.

CHAIRMAN BUTTREY: Thank you very much. We will next turn to the railroad panel. We will have the railroad witnesses appear individually not as a panel. Excuse me. I didn't mean to use the word panel. Vice Chairman Mulvey and I will be asking questions as we have in the other situations.

The first witnesses will be with BNSF Railway Company. We'd ask them to come forward please. We'll take the railroads one at a time.

Thank you very much. You're welcome to proceed.

MR. HUNT: Good afternoon, Chairman Buttrey and Vice Chairman Mulvey.

I'm Tom Hunt. I'm the CFO with Burlington Northern Santa Fe and I appreciate you providing me with the opportunity to speak on this important topic for BNSF.

So, let me address a few key points of our fuel surcharge program.

First of all, the objective of the BNSF fuel surcharge program is to recover the increase in fuel expense and the fuel surcharge program is in response to the high cost of fuel and also the high price volatility. The fuel surcharges are common in many other type of industries such as steamship lines, utilities, trucking, barges and as was published in the Wall Street Journal last week, we've lawn services and pizza delivery companies instituting fuel surcharges.

The next slide shows that from 2001 to 2005 fuel expenses increased approximately $1.5 billion which is a compounded annual growth rate of 25 percent and this is more than four times the rate of increase in all of our other expenses during this same time period.

This slide illustrates three points. First, fuel has been steadily rising. Second, the price of fuel is very volatile and third, there is a high correlation between highway diesel fuel price and BNSF cost of fuel and the biggest difference between the highway diesel fuel and the BNSF cost is taxes and we use the highway diesel fuel as the fuel surcharge program bench mark because it's a widely accepted public statistic.

But, several have claimed that by using highway diesel fuel we're over recovering as opposed to our own cost and this is not correct as we're measuring the change over time and unless the spread between the two prices widens significantly which it's clearly not doing on that graph, there's no over recovery occurring.

And let's talk about our hedging program because that's come up through a number of people's discussion today and as it says in the headline of this slide, hedging is independent of fuel surcharge.

Hedging is a cost containment strategy, a risk containment strategy where you lock in a future price or a future range of prices. It's like purchasing insurance and deciding what your deductible should be and what you're limits should be on your property insurance policy. But, there is no free lunch and as shown on the bullets up there, if prices rise, you win. If prices fall, you lose and in 2005, our fuel expense was reduced by 21 percent due to hedging. However, in 1998 when fuel prices were low, our fuel expense was actually increased by 13 percent due to hedging and we, in 1998, did not receive any compensation from our customers for that increase in fuel expense and, therefore, shortfall in profitability relating to our hedging activities.

And finally, many of our customers are in commodity businesses and they're clearly familiar with hedging strategies.

Well, let's get into the details of the actual surcharge program. The history of our program, and this is before the mileage-based program which started this year, was that the truck fuel surcharge program is widely accepted and recognized and we originally used a percent of freight bill primarily because it was easy to administer and the entry point was adopted based on historical average cost of highway diesel fuel which as we saw earlier has a high correlation to BNSF's price per gallon of the diesel fuel we consume and finally, BNSF charges a lower percent of the freight bill than the truck surcharges.

Well, starting in the first of this year, we moved to a mileage-based program for certain groups and let's talk about that because there's been a lot of commentary today about that program.

Well, first of all, a mileage-based program reflects fuel usage and the tables are built on a business unit by business unit basis for fuel intensity and the mileage table is based upon rail miles and the intent of our mileage-based program is to only recover our cost above threshold and align the surcharge with fuel consumption. The mileage-based program was initiated for non-interline traffic for coal and agricultural commodities on January 1st, 2006 as a response to our customer concerns. Interline moves on these two commodities still move on a revenue-based surcharge because of the shared movement and therefore, the shared billing between the various carriers.

Consumer and industrial products, our remaining two business units, were not converted to mileage-based upon customer concerns and customer feedback and we expect consumer and industrial products to convert to a mileage-based program over time and if they don't, then we intend to make adjustments to avoid for the potential of over recovery resulting from the compounding effect of rate increases.

Let's actually look at the numbers from

BNSF's perspective and these numbers you can actually tie back to our 10K filed with the SEC. The question is are we over recovering and the answer no, not in any year from 2001 to 2005 nor for the five-year period and if you see the number up in sort of the upper left-hand corner, you can see that we have under recovered over that five-year period by $1.1 billion. Now, this is BNSF fuel expense absent the hedge compared to the recoveries from fuel surcharges.

Also, some assert that we over recover in one line of business and in effect, subsidize others and for the five-year period and for the year 2005, all four of our business units fell short of recovering their cost of fuel.

Three of the business units in 2005 recovered a significant amount, i.e., 75 percent or more of the increase in fuel above base while coal, the other business unit, recovered well under 50 percent above its base.

So, fuel surcharge is clearly not a profit center at BNSF.

But, as I stated earlier, we will continue to monitor the program and over time do not intend to over recover while still administering a workable program and if we find on a business unit basis over time we are over recovering, we will make adjustments to the program.

So, in conclusion, BNSF's fuel surcharge was implemented to cover escalating fuel cost. BNSF is not fully recovering fuel cost above the base price. BNSF has reacted to customer concerns in the marketplace and BNSF believes that a mileage-based fuel surcharge is the most reasonable and appropriate approach.

And finally, all of the details of our surcharge program are readily available on our website BNSF.com.

Now, that's the end of my slides, but I do have a couple of comments and I modified some of the comments that I made based upon some of the testimony that I've heard this morning, but I do want to touch on two other points that have been brought up this morning and I'm sure they would be things that are clearly on your mind in -- to other people's questions on them as we've gone through the morning and the early part of the afternoon.

First of all, why is the rate on the mileage-based program for grain greater than coal? Let me give you a couple of things. First of all, I'll start by saying the mileage-based program has only been in effect for four months. So, therefore, we're still working through what I'll call the start up of a new methodology. But, there are clear differences in the business model for coal versus ag.

Difference one, coal moves exclusively in unit train operation. Ag moves some in unit train and some in single car movement.

Second is speed. Coal typically moves at the slowest speed on the railroad while ag moves at a variety of speeds sometimes depending on which train it's on and therefore, the higher the speed, typically, the more horsepower you have. Horsepower being locomotive power and therefore, the more fuel intensity you have.

The third activity that causes a difference between the two is the switching activities, i.e., activities in the yards where there's fuel being consumed, but not real mileage being added. Coal incurs very little switching activity. Ag, especially, the non-unit train agricultural movements, rather, incur switching activities and then finally weight, which was brought up by one of the individuals earlier, especially on the empty moves. Moving the aluminum cars back as opposed to unit grain trains back clearly causes a difference.

So, I think really the question is not so much why is coal different than ag, but is ag unit train different that ag single car and we have one ag rate. We've debated whether we should actually have two ag rates and that's something I think we'll consider in the future, but right now, we just have the one rate.

But, those are the differences between coal and ag businesses which cause ag to be more fuel intensive than coal.

The second thing I'd like to comment on is this whole issue of RCAF and rail cost adjustment factor. First of all, we have very few contracts, I mean we're talking a very small percentage that actually have a full RCAF and fuel surcharge on them.

But, from our perspective, RCAF is not really the best recovery methodology and the best match anyway because RCAF is a nationwide average that doesn't reflect the higher fuel usage of a long distance carrier like BNSF.

And secondly, as was indicated in the last panel, the weights aren't necessarily reflective of the current weighting of fuel cost especially for a long haul carrier like BNSF. It really doesn't reflect the volatility and the quickness of the movement.

Then thirdly, there are timing differences and estimations differences that the previous panels have talked about.

And finally, many of our contracts only provide for a percent recovery of RCAF as opposed to full RCAF.

And so, when you add all that up, RCAF has woefully under recovered for us and we don't believe that there should be any double counting here at all. Actually, we believe the best model should be a mileage-based fuel surcharge coupled with an index that describes an all inclusive less fuel index which would be RCAF absent fuel and we think that's the best model and that would address the concerns of most of the parties that spoke on that topic today.

So, that's the extent of my prepared comments. I'd be ready to answer to questions unless you want to ask questions as a panel.

CHAIRMAN BUTTREY: We're not going to do a panel.

MR. HUNT: Okay.

CHAIRMAN BUTTREY: We'll just ask the questions individually.

MR. HUNT: That would be just fine.

CHAIRMAN BUTTREY: There's been a lot made about who's paying this and who's not paying this and we've heard a little bit of everything really.

Do you have any idea what percentage of your traffic is not paying the fuel charge because there's a contract or for some other reason?

MR. HUNT: We disclose our effectiveness rate and we did it on the last analyst call at around 75 percent expecting we do about 80 percent by the end of this year.

As I indicated through 2005, the business units that clearly had fairly high recovery were coal, or I'm sorry, ag, industrial and consumer products. Coal is the one that clearly is significantly under recovery.

MR. HUNT: And that's because of contracts.

CHAIRMAN BUTTREY: And you can unequivocally state for us today that the fuel increase that you're trying to recover is not the fuel increase that you're losing under contract?

MR. HUNT: Are you saying a cross subsidy between the two?

CHAIRMAN BUTTREY: Right.

MR. HUNT: No, each of the business units and again, from my perspective, you know, we're looking at this on a business unit by business unit basis, each one of them under recovered last year.

CHAIRMAN BUTTREY: Across the board?

MR. HUNT: Yes, all four business units.

CHAIRMAN BUTTREY: Okay. If the indexing methodology that might be adopted in the future was something other than what you're using today, what would you recommend as an alternative?

MR. HUNT: I think something that has a high correlation to the fuel we consume and that -- remember the slide that showed the two lines going in parallel. Something that has a high correlation and if it was something that actually was, you know, an off-highway diesel fuel that was a published statistic, I think there's two things that have to be there, high correlation and public visibility.

You know, as long as we find something like that, I think it's fine. I think, you know, pure oil is not the best because it doesn't include the refining component.

VICE CHAIRMAN MULVEY: Thank you. Your company began to view the RCAF as an inadequate method by which to recapture the increased fuel cost. Couldn't you have petitioned the Board for a change in the way RCAF is calculated?

MR. HUNT: I imagine we could have. That's probably a bit of, I'll say, almost a regulatory question. I'm not a regulatory attorney.

What we have done is we have calculated an index that essentially mirrors RCAF and therefore, is the all inclusive less fuel and then put the fuel surcharge with that and in most of our contracts that are coming up, that's what we actually are using.

VICE CHAIRMAN MULVEY: So, you have the RCAF with the fuel taken out of it.

MR. HUNT: Right.

VICE CHAIRMAN MULVEY: And then put on the surcharge. So --

MR. HUNT: Correct.

VICE CHAIRMAN MULVEY: -- in your estimation, you're not double dipping in any of these contracts?

MR. HUNT: That's correct and as I said before, there are a very small percentage of contracts that have I'll say a full RCAF and fuel surcharge and that was known at the time we negotiated the contracts with the customers and that's a small percentage.

VICE CHAIRMAN MULVEY: There's been some charge that the fuel surcharge program does not account for efficiency gains. That the railroads achieve tremendous efficiency gains as they're putting in newer locomotives, replacing the older, less fuel efficient ones.

Is there any way to factor in the fuel efficiency gains or do you think that that's being done?

MR. HUNT: I think over time that needs to be accounted for. I would also say that fuel efficiency is something that moves at almost a fairly glacial pace. A 1 percent improvement in efficiency in a year is a big deal. You know, so it's -- the locomotive -- you think about the turnover in the fleet. We've got over 5,000 over the road locomotives on our property and probably over 6,000 in total counting the road switchers and all that and in a big year, we get 300 new ones. So, it moves at a slow pace.

Over time if we achieve significant

efficiency, we should be adjusting the program to reflect that.

VICE CHAIRMAN MULVEY: You can understand how the shippers feel though. In a sense, some shippers feel that look, you've signed these contracts with other shippers where you've agreed to not levy any fuel surcharges and now, you're coming to us to raise our rates effectively or institute these practices for us to cover the costs of serving others and you can see why the shippers would consider this to be unfair. You made these deals and you signed these contracts. Why shouldn't you bear the burden of the errors in signing contracts that don't allow you to recover all of your costs?

MR. HUNT: And I'd say we do bear the burden of that. That's why in my comments earlier I said coal recovering well less than 50 percent.

The place where we have contracts that are longer term where we've not had I'll say rollover and therefore, an opportunity to negotiate a fuel surcharge is really in coal and that's where we are under recovery and when we think about, you know, the fuel surcharge I talked about, a 75 percent effectiveness, that the vast majority of that 25 percent difference exists within the coal business group. So, I think we are absorbing that.

VICE CHAIRMAN MULVEY: In one of your charts, the bar chart, titled Cumulative Under Recovery. Fuel expense above threshold. What is a threshold?

MR. HUNT: Well, I'll give you the exact answer.

VICE CHAIRMAN MULVEY: Is that yes.

MR. HUNT: Seventy-three cents BNSF or it's about $1.25 highway diesel fuel.

VICE CHAIRMAN MULVEY: And that's 2001 based?

MR. HUNT: Yes, it's --

VICE CHAIRMAN MULVEY: I was trying to figure out, why the word threshold was used instead of a particular time or a particular number.

MR. HUNT: Our surcharge program is the same for all customers and it's highway diesel fuel and then it starts at $1.25 and ratchets up from there.

VICE CHAIRMAN MULVEY: But, that suggests that an off-highway diesel fuel would be better because it doesn't take into account a lot of the other charges that are put in highway diesel fuel. How do you feel about that?

MR. HUNT: Back to the question earlier, I think as long as we find an index that has a high correlation to what we burn and is publicly available and agreeable to all parties, I have no problem with that.

VICE CHAIRMAN MULVEY: Thank you.

MR. HUNT: Yes.

VICE CHAIRMAN MULVEY: Doug.

CHAIRMAN BUTTREY: I don't have anything else.

VICE CHAIRMAN MULVEY: Thank you very much.

MR. HUNT: Thank you.

CHAIRMAN BUTTREY: Our next witness is Canadian National. Good afternoon.

MR. FOOTE: Good afternoon, Mr. Chairman, Mr. Vice Chairman. Thank you for the opportunity to be here today.

For the record, my name is Jim Foote. I'm the Executive Vice President, Sales and Marketing with Canadian National.

With me today is Jean-Jacques Roue who is CN's Senior Marketing Officer.

I'd like to just go through some very, very brief remarks as we have already provided our written comments and answer any questions that you might have.

In 2000, faced with the rising fuel costs, CN, as did all other companies, began to look for ways to reduce the exorbitant expense we were faced with in rising diesel fuel and a surcharge was looked at as a way to do this. Our main focus at that time was, number one, that whatever we do be fair. Two, that it be easy to understand. Three, that it be easy to administer and four, that it not be a profit center.

We implemented our first fuel surcharge in 2001 with our CN tariff 7400. The starting application of that fuel surcharge at that time was when the price was $24 WTI. We adjusted that quarterly based on the cost of WTI and we adjusted the fuel surcharge up 2 percent for every increase of $5 in WTI.

We kept that fuel surcharge in place for a number of years until after further evaluation. In the spring of 2005, we introduced a new fuel surcharge. That fuel surcharge starts applying a $25 a barrel WTI versus the 24. It is adjusted monthly based on the average price of WTI. The initial charge is 1.5 percent instead of the original 2 percent and each increase in $1 of WTI would take up the price curve on the fuel surcharge of .3 of 1 percent. That was a 25 percent reduction in our fuel surcharge.

Again in 2005 in the fall, we reduced our fuel surcharge tariff again. This time another 16 percent. Same starting point, $25. Same monthly adjustment. Same initial 1.5 percent application, but we were able to reduce the curve from .3 of 1 percent to one-quarter of 1 percent for each increase in the price of -- dollar of WTI.

How we've been able to do this, we've

worked extremely hard to have universal application of our fuel surcharge. Eight-seven percent of our eligible customers pay the tariff fuel surcharge. The other remainder have other recovery mechanisms in there for fuel primarily based on the legacy language in their contracts.

My focusing on universal application of this fuel surcharge, we've been able to reduce what today at $70 a barrel would have been a 20 percent fuel surcharge down to 12.75.

In conclusion, we have focused on simplicity. We have focused on universal application. We have been flexible and made changes where we thought it was appropriate. Most of all, we have been fair. We have not over recovered. If the circumstances dictate that we should reduce the fuel surcharge again, we would do so.

Thank you. Answer any questions you might have.

VICE CHAIRMAN MULVEY: Thank you. You said that 87 percent of eligible customers pay the fuel surcharge. What is the population of ineligible customers?

MR. FOOTE: It is about 3 percent of our business which is regulated Canadian grain.

VICE CHAIRMAN MULVEY: I see. Okay. So, then you don't have a lot of contracts which preclude the charges --

MR. FOOTE: Basically, the remaining 13 percent.

VICE CHAIRMAN MULVEY: Most of those are subject to the RCAF?

MR. FOOTE: No, they would have other fuel mechanisms--

VICE CHAIRMAN MULVEY: Other fuel mechanisms? Okay. Okay.

CHAIRMAN BUTTREY: Contractual fuel.

VICE CHAIRMAN MULVEY: Contractual fuel.

MR. FOOTE: Correct. Yes.

CHAIRMAN BUTTREY: Escalation clause.

MR. FOOTE: Correct. Yes.

VICE CHAIRMAN MULVEY: Okay.

CHAIRMAN BUTTREY: Or limitations thereof.

MR. FOOTE: Yes, sometimes they're WTI.

Sometimes they're just CPI. They're all over the place and we're trying clean those up as well.

VICE CHAIRMAN MULVEY: Have you been successful in recapturing all your increased cost of fuel since the run up in fuel costs began through your fuel surcharge program?

MR. FOOTE: We are at that point now.

VICE CHAIRMAN MULVEY: Okay. Does your fuel surcharge program account for fuel efficiency gains or do you have any way of factoring in fuel efficiency gains?

MR. FOOTE: We would look at our entire fuel expense and if we thought that it was appropriate or we were getting to the point where we were overcharging in any way, shape or form, we would adjust it to take that into consideration.

VICE CHAIRMAN MULVEY: Okay.

CHAIRMAN BUTTREY: What part of your elements of your program do you get the most push back from your customers? I'm just curious.

MR. FOOTE: All of them. Yes.

CHAIRMAN BUTTREY: Okay.

MR. FOOTE: You know, it is what it is. I mean it's an increase in transportation costs. I mean there's no way around it. One of the things we try --

CHAIRMAN BUTTREY: It's not the index or nothing stands out as being a particular problem. It's everything.

MR. FOOTE: Number one, in order to get universal application, and you've heard that today here, we had to be very arbitrary about the fact that everybody pays it. Some people don't like that. But, that's the only way you can drive down the cost is by spreading it across the entire base and that's the position we took from day one.

Secondly, if you look at our freight rate increases during this same period of time, I think our freight rate -- general freight rate increases have been lower than the average during this period as well. So, we try to be reasonable in the imposition of what has been viewed by some as a hard line that we've taken on this.

CHAIRMAN BUTTREY: And you can

unequivocally say for the record that you're not over recovering your fuel costs?

MR. FOOTE: That's correct.

CHAIRMAN BUTTREY: Okay. Your other Canadian railroad will be testifying here in a moment and the witness is just setting real close behind you there. So, I just want to let you know that they're right there. I was going to ask you a question.

MR. FOOTE: Very cognizant of that.

CHAIRMAN BUTTREY: How does your program compare to other Canadian competitor in terms of your percentages and how it's been received?

MR. FOOTE: To the best of my recollection, to the best of my knowledge, I think in terms of what we base it on and the application, et cetera, it's a reasonably similar program. We have a higher level of application, higher number of customers paying it than I think most do.

Again, that's not necessarily applicable just in fuel surcharge. We take that position in just about every chargeable service that we have and have a reputation unfortunately for being arbitrary sometimes in those, too. But, whatever charge we have we try to not discriminate and have across the board application.

I think CP's coverage at least from what I see from the published reports is slightly lower. I don't know why. They're a much bigger coal hauler. I don't know the nature of their contracts.

CHAIRMAN BUTTREY: Um-hum.

VICE CHAIRMAN MULVEY: You also use West Texas Intermediate as the base for your rates --

MR. FOOTE: Correct.

VICE CHAIRMAN MULVEY: -- for the big changes? How do you feel about moving to something like off-highway diesel fuel index?

MR. FOOTE: Again, you know, the number one factor here is clarity under -- does everybody understand it. I mean everybody knows crude. I mean you can ask the guy that drove the cab today what the price of crude was and they'll tell you. It's a recognizable index to tie to.

You can dream up a market basket of all kinds of factors that great minds would agree was exact, but can you understand it and apply it?

So, whatever the index that is used as long as everybody understands it and it doesn't create confusion and more than anything confrontation in the application of it, it is what is.

VICE CHAIRMAN MULVEY: Thank you.

MR. FOOTE: Thank you very much.

VICE CHAIRMAN MULVEY: Thank you very much.

CHAIRMAN BUTTREY: The next witness is I believe Canadian Pacific Railroad. Welcome this afternoon.

MS. SZEL: Good afternoon, Chairman Buttrey, Vice Chairman Mulvey.

As you know, my name is Marcella Szel and I'm the Senior Vice President of Marketing and Sales for the other Canadian railroad Canadian Pacific Railway and I'm responsible for all aspects of the company's marketing and sales efforts which includes our fuel surcharge program and I thank you very much for this opportunity to speak with you here today.

Now, my written testimony discusses in

some detail the reasons why we found it necessary to add a fuel surcharge to our base rate. The principles that guide our program --

CHAIRMAN BUTTREY: Excuse me. Excuse me just a moment. For some reason, it doesn't seem that your microphone is working very well. It might not be on. It might not be close enough.

MS. SZEL: How about this? Is that better?

CHAIRMAN BUTTREY: That's better.

MS. SZEL: Thank you.

CHAIRMAN BUTTREY: We should be able to hear you a lot better. Thank you.

MS. SZEL: So, I'll just repeat that last bit. My written testimony discusses in some detail the reasons why CPR has found it necessary to add a fuel surcharge to the base rate, the principles that guide our program and the manner in which the surcharges are calculated for each of our major U.S. market segments.

In my remarks today, I'd like to emphasize four points that I believe are critical understanding our program.

First, contrary to some claims being made by some parties, the incremental fuel surcharges collected by CPR have never exceeded the year over year increases in the price of diesel fuel. Even with our efforts to expand the program to include all of our business and periodic adjustments to the level of a surcharge, we have consistently under recovered against the incremental price of fuel.

Secondly, CPR does not engage in any practices such as imposing a fuel surcharge on traffic that is also subject to an RCAF adjustment that might result in double recovery of fuel costs from a particular customer.

Third, CPR's policy is that all shippers should share the burden created by skyrocketing fuel prices. We currently apply some form of fuel recovery mechanism to more than 90 percent of our U.S. business and we have measures in place to bring the balance of our business into the program as soon as we can.

And fourth, CPR's current fuel surcharge program represents a reasonable balance between the goals of having a workable program and allocating the rising price of fuel in a fair or equitable manner.

So, first some context. The figures that I'm referring to in my remarks today are based upon our U.S. operations. I think it's important also to understand the vast majority of our U.S. business that I refer to moves under transportation contracts. Thus, all matters relating to price for such movements including fuel surcharge are the product of negotiations with our customers.

Now, having said that, the fuel cost management is a critical business issue and fuel is CPR's second largest expense item. In 2005, we spent more than half a billion dollars for fuel and more than 100 million for our U.S. operations. The extreme volatility of fuel prices represents a serious challenge. In the first four months of this year alone, the price of crude oil has increased by about 20 percent. Therefore, CPR like virtually every company that consumes fuel in providing services to customers has found it necessary to add a fuel surcharge.

First let me address the issue of over recovery. From the outset, our program has been designed to permit us to recover the increasing price of diesel fuel and nothing more. CPR has never been able to offset fully the year over year price increase. Our incremental fuel surcharge revenue during 2005 covered only 80 percent of incremental price increases from '04 to '05. Looking further back, the fuel surcharge revenue collected in '04 covered only about 50 percent of the incremental price increase from '03 to '04. So, as these figures show, CPR itself is absorbing a substantial share of the economic burden associated with the rising price of fuel.

Second, with regard to double recovery, we do not double recover. Some parties have expressed concerned that railroads might be double recovering by applying the surcharge on top of other pricing mechanisms that already compensate for changes in fuel.

For example, it's been suggested that this occurs where a movement is subject to both a fuel surcharge and periodic rate increase based on RCAF index which as we all know measures among other things the changing cost of fuel. CPR does not engage in these practices.

While RCAF based increases were once a common feature of many of our transportation contracts, in recent years, we've moved away from RCAF as a mechanism for recovering incremental fuel costs. Today, with some few exceptions, CPR's fuel surcharge tariffs not RCAF provide the mechanism for adjusting the rates paid by our customers to account for the rising fuel prices.

Where RCAF based provisions do remain in a few of our legacy contracts, we do not also impose a fuel surcharge on top on those contracts.

It has also been suggested that recent base rate increases reflect some or all of the rising price of fuel. CPR's approach is to use the base price to deal with the marketplace factors of demand and capacity in our investment requirements while we rely on the surcharges to manage the fuel exposure.

You know, for instance, at the beginning of this year if I had tried to enter into a contract with my customer to predetermine what the cost of fuel is going to be, I would never have guessed it would have risen 20 percent in the first quarter. So, we try to manage that separately.

Third, a broad program, like other railroads, CPR faced limitations on its ability to impose fuel surcharges on all customers during initial stages of this program. Now, CPR has a policy requiring that all new transportation contracts or rate quotations incorporate fuel recovery specifically. I've personally issued strict instructions to all of our marketing managers that this policy be applied to all customers. As a result, we now collect some form of fuel recovery in connection with more than 90 percent of our U.S. business.

As older contracts expire, our goal is that no shipper receives a free ride at the expense of others.

Fourth, CPR's program strikes reasonable balance. Concerns have been raised about whether the methods used by railroads to calculate their fuel surcharges are fair to all shippers and naturally, no shipper wants to pay more than his fair share of the skyrocketing cost of diesel fuel.

We understand these concerns and we do not claim that our fuel surcharge program is perfect in individual application, but given the enormous diversity in transportation characteristics of the traffic we handle and the need for a program that is both workable and easy for customers to understand, it is simply not practical for us to tailor the surcharge on every shipment to the exact characteristics of that shipment.

As other railroads, we handle hundreds of thousands of combination of commodities, car types, weights, distances, terrain, speeds and other factors that affect fuel consumption. Trying to calculate a specific fuel surcharge for each one of these movements much less invoicing thousands of different surcharges accurately would be extremely burdensome, costly and I suspect prone to invoicing inaccuracy and adopting such a complex system would do absolutely nothing to reduce the total amount that CPR must try to collect to offset the rising price of fuel.

However, CP's fuel surcharges do reflect to some degree the transportation characteristics of the three broad categories of traffic that we handle, carload, intermodal and grain.

Our decision to express fuel surcharges as a percentage of the freight rate is based on several considerations. First, this is a common practice not only in the railroad industry, but among other transportation providers as well.

Second, a fuel surcharge is part of the total freight rate. So, linking this surcharge to the base rate is logical.

Third, it is simple to calculate and easy to administer. This is especially important in connection with the large volume of CP's traffic that moves on an interline basis. Only a tiny fraction of our traffic which moves in the Soo and the D&H is actually local business and I mean a tiny fraction.

Much of our U.S. traffic is forwarded from Canada under contracts influenced by the Canadian environment and much of our traffic requires cooperation with our connecting carriers in the United States and as the Board knows, it's important that interline shipments move as seamlessly as possible. So, for CPR and its shippers, it makes sense to use the same percentage-based system as our U.S. connections are using for implementation.

Now, we've heard a suggestion here today by a number of people that there might be a simple solution which is a mileage-based type formula. This might have some appeal, but alone, a mileage-based system is not a silver bullet in this circumstance and you just have to think about driving. If you're driving the same car with the same weight and the same road with the same weather from here to New York and you drive at 50 miles an hour versus driving at 70 miles an hour, you're going to have different fuel consumption.

Take that very same drive and drive a fuel efficient Toyota and compare it to let's say a Ford Mustang with a high horsepower, you're going to have another completely different fuel usage. So, these are characteristics of traffic.

So, in our case when we have intermodal traffic that's speedy movement, scoots around other trains wherever it can, high horsepower to ton ratio, it, in fact, has a higher fuel surcharge than our other traffic to account for that type of other characteristic.

CP has revised its surcharges several times in response to customer feedback and our assessment of the likelihood that the surcharges will appropriately offset the incremental increase in the price of fuel. For example, recent changes have resulted in lower fuel surcharges for both carload traffic and grain.

We are, of course, prepared to consider constructive suggestions for improving our program in ways that would allocate the price equitably while maintaining a system that is administratively workable.

So, in sum, our fuel recovery program is designed to recover only incremental changes in fuel price in the aggregate. So far, we are not achieving full recovery.

Our surcharges may not be perfect in their distribution, but that's the tradeoff between a perfect program and one that is workable.

Thank you. Happy to answer any questions.

CHAIRMAN BUTTREY: Thank you.

VICE CHAIRMAN MULVEY: The fuel surcharge program you have here in the United States on U.S. traffic, do you have a similar program or the same type program for inter-Canadian traffic or is it different?

MS. SZEL: Some of it is different. We have a very specific U.S. grain fuel surcharge program which is different than what we have in Canada.

VICE CHAIRMAN MULVEY: Could you briefly explain the difference between the two?

MS. SZEL: Well, first of all, it was implemented much later and I'm not happy to say that the reason why it was implemented much later is that in the years when we were bringing on our fuel surcharges we were in very serious service recovery program with our grain business in the United States and we just didn't think it was fair to impose a fuel surcharge when our customers were very unhappy and rightly so with our service.

So, number one, it was implemented later and the rate on the fuel surcharge in grain is lower than all the other programs. For instance, intermodal traffic is 13.25 percent and U.S. grain is 9.46 percent.

VICE CHAIRMAN MULVEY: But, it has the same basis as the United States; your approach, methodology, is similar in both Canada and the United States?

MS. SZEL: Same methodology. We use on-highway diesel price in the United States. We use WTI plus a crack spread in Canada.

VICE CHAIRMAN MULVEY: You say that a mileage-based rate would not be the silver bullet but wouldn't a mileage-based rate with some adjustments still more closely reflect cost differences than a rate-based rate?

MS. SZEL: So long as you were able to construct something that accounted not just for the miles, but accounted for all the other characteristics and the movement then one might argue that it would appear to be fairer.

VICE CHAIRMAN MULVEY: Well, you can't account for everything. I don't think it's possible to have a surcharge that would account for all the differences in all of the shipments. Something that at least captured major differences like, for example, weight or terrain or things like that. I mean I have, seen the programs that the various railroads have, including CP's, for monitoring traffic and they are very, very detailed and very, very specific. You can always tell people exactly where their shipment is at any moment in time or at least within some distance of where it is.

And it strikes me that you could construct algorithms which could calculate the fuel surcharge with a little more precision, a little more correlation to the fuel cost than a rate-based one which is based upon differential pricing.

MS. SZEL: I suspect you could construct an algorithm for almost anything, but I can assure you that I'm not the person who's going to do and that's a fair comment. But, I do repeat that some of the other characteristics of traffic are significant. A higher speed train that requires greater handling uses significantly more fuel than one that doesn't and that's a very significant factor and just because you might know where all your cars are at any given time, it doesn't necessarily mean that that correlates to fuel usage.

VICE CHAIRMAN MULVEY: I meant through calculating what the average speed of that train was going to be, in fact, in matters of the surcharge in the general way.

CHAIRMAN BUTTREY: I think I heard you say over time, over the last year or so or two years, you're still recovering I think you said only about 80 percent of your fuel costs.

MS. SZEL: Yes, that's true.

CHAIRMAN BUTTREY: Increased fuel costs.

MS. SZEL: Increase in fuel cost.

CHAIRMAN BUTTREY: Right.

MS. SZEL: Yes.

CHAIRMAN BUTTREY: Right. Okay. And you say that the reason for that is because some of the people came into the program late and because some of the people using the service have contracts or other agreements that preclude that. Is that what you were saying?

MS. SZEL: Well, it's probably a combination of, for instance, when you've got a differential in your fuel surcharge. You know, for instance, less in the ag business, more in the intermodal business. You're always going to have a spread and it would be unlikely that you would truly recover 100 percent.

CHAIRMAN BUTTREY: Yes.

MS. SZEL: Our goal is to ensure that we spread it as equally as we can among our shippers and achieve 100 percent coverage so that 100 percent of our customers are, in fact, contributing to that fuel surcharge.

CHAIRMAN BUTTREY: I don't know whether you were here this morning when we had a lot of shippers coming in and consultants for shippers coming and they were basically saying that all the carriers are recovering way above what their increase in fuel costs are and it's almost like we're talking about apples and oranges. There's a total disconnect here between what the parties, the witnesses have said today. It's difficult to understand that.

MS. SZEL: It's an accurate observation.

CHAIRMAN BUTTREY: A total disconnect.

MS. SZEL: Yes.

CHAIRMAN BUTTREY: Any other questions?

VICE CHAIRMAN MULVEY: No, not at this time. Thank you very much.

CHAIRMAN BUTTREY: Thank you very much.

MS. SZEL: Thank you.

CHAIRMAN BUTTREY: Our next witness is from CSX Transportation. Welcome. Good afternoon.

MR. JENKINS: Thank you. Good afternoon. We have Power Point slides. So, if you'll give us just a second here.

CHAIRMAN BUTTREY: We're shocked. You gentlemen may proceed whenever you're ready.

MR. JENKINS: Mr. Chairman, Mr. Vice

Chairman, I apologize for the delay.

My name is Chris Jenkins. I'm the Vice President of Coal and Automotive for CSX Transportation and I'm accompanied today by Pete Shudtz from our Washington office.

We appreciate the opportunity to speak with you on what's really a critical topic of CSX and that is the recovery of our fuel costs and also to talk about how we are going to meet the demands of our customers for more service and more transportation capacity.

Pressure's building on us so that we can move more goods efficiently. For the first time in a generation, demand for transportation on CSX has challenged our capacity. Imported goods are flowing at a faster pace. Every manufacturing industry has shown more interest in rail transportation and greater demands for us to get their goods to the distribution and consumption points.

Now, to meet those challenges, we've got to expand our physical plant. We're rising to that challenge. In 2001, we spent a billion dollars on capital. Same number for 2002, 2003, 2004 and 2005. A billion dollars a year. Maybe 1.1 billion in 2005.

But, in 2006, we're going to spend $1.4 billion and most of that increase is going into capacity expansion projects. On the Chicago to Florida corridor, for example, we're putting in dozens of new passing sites and extending existing passing sites on a corridor that has seen no capacity for 50 years.

So, what does all that have to do with fuel surcharges? Well, the answer is this. That while we are spending more on capital, in this case an increase of about $300 million shown by the blue bars between 2005 and 2006, we're also spending or spent in 2005 $614 million more on diesel fuel than we spent in 2001 and we project that in 2006 we'll spend $859 million more on diesel fuel.

So, unless we can find a good way to recover that increase in fuel cost, we will hurt our ability to make the capital improvements that are so badly needed.

I think we're ready. Next slide.

Well, here are the numbers. This is our total fuel cost 2002 through 2005. You can see we spent about $2.8 billion in fuel and about a third of that or 1.1 billion has been due to the increase in cost of fuel from 2001.

Well, so, what do we do? You know, our view has been that we need to do exactly what other businesses are doing whether they're airlines, steamship companies, florists. We need a fuel recovery charge and that really we needed to ask our customers to cover the incremental cost of fuel.

Now, I only wish our program was as efficient as has been suggested. It has not been a profit center for us. In fact, we have under recovered $319 million in fuel over the last four years.

Stated differently, our incremental cost of fuel exceeded what we recovered in the fuel surcharge by $319 million. All of our figures excluding gains or losses from hedging. We're talking here about pure fuel costs. So, $319 million that we have been unable to recover.

Now, we're working on this, but the shortfall has a real intangible effect on our ability to respond to the strong demand for our services.

The fuel surcharge program that we put in place is designed to help us achieve that recovery. We believe it's fair, it's appropriate, and it is consistent with the principles of differential pricing.

In our commercial transactions, negotiating the price occurs simultaneously with discussion of the fuel surcharge and all of the other terms and conditions of our contract prices and in effect, the fuel surcharge is part of the price, part of the rate.

What we're trying to do is to distribute as fairly as we can the cost of fuel across our traffic base and we think price provides a very good mechanism for determining how that allocation should take place because price does consider weight and distance. It considers competitive factors. It considers grades, and other operating considerations. Price incorporates an enormous amount of information about a piece of business.

The other advantage of using price is that it prevents us from charging a fuel surcharge that's too high on some of the lowest rated business. A surcharge that might drive that business away and give us fewer revenues and carloads to spread our fixed costs over.

So, you know, as we go forward, there are a few things to mention. First of all, we think our program is very transparent. It is linked to WTI which is extremely visible. We publish on our web fairly extensive information about calculation of the surcharge for the current month as well as for upcoming periods and it's also the case that as we recover our cumulative losses, we are willing to make adjustments in the program so that it is generating an amount that is consistent with our incremental fuel costs and does not create an over recovery. We want to be competitive, responsive to customer needs.

I want to close just by referring to the point that I made earlier. Our customers want us to move more traffic. We have got to add capacity to do that and we can only add capacity if we're generating an economic return that allows us to make those investments and in order to do that, we got to take care of the challenge presented by high fuel prices.

Thank you very much and I'd be pleased to take any questions you may have.

CHAIRMAN BUTTREY: You said you had a 319 million shortfall in full cost recovery.

MR. JENKINS: Yes.

CHAIRMAN BUTTREY: What does that 319 million represent?

MR. JENKINS: Well, the 319 million is basically the difference between the amount that we have spent in fuel above our 2001 costs and what we've gotten back through the fuel surcharge. So, we've recovered 319 million less with the fuel surcharge than what we've paid out in excess fuel costs and that is due to the fact that we don't have complete coverage of the fuel surcharge on all of the traffic. We do have contracts particularly older contracts that don't contain fuel surcharge provisions and we're working as those contracts come up for renewal to get fuel surcharge coverage and broaden the coverage to the point where we get just about all the traffic included.

CHAIRMAN BUTTREY: Do you have any idea why there's such a total disconnect between what you're saying and what all the other witnesses this morning were saying?

MR. JENKINS: I am very sure our numbers are correct and that we know what we have spent on fuel in an incremental sense and we know what we've brought in on the surcharge and so, I can't really address how their computations were done, but we are very sure that ours are correct.

CHAIRMAN BUTTREY: And they seem to be very sure that theirs are correct.

MR. JENKINS: There is a difference of opinion.

CHAIRMAN BUTTREY: Everybody's entitled to their own opinion, but nobody's entitled to their own facts.

VICE CHAIRMAN MULVEY: As Disraeli says there are lies, damn lies, and statistics. So, I'm not sure what we have here, but Mr. Buttrey is right. I mean there should be facts here. They should be knowable. They should be calculable somehow or another.

Let me ask you a couple of questions. You said that you're not recovering all of your fuel surcharges. Some contracts don't allow them. And you said that you have a $320 million shortfall over the period. Do any of your contracts have RCAF provisions in them which would factor in some of the fuel increases?

MR. JENKINS: Yes.

VICE CHAIRMAN MULVEY: So, at least some of them would be -- so, your shortfall is just the difference between the increased price of fuel and what you recovered from surcharges.

MR. JENKINS: That is correct.

VICE CHAIRMAN MULVEY: Well, then you've also recovered some through an RCAF.

MR. JENKINS: There is RCAF that applies on some of the contracts, but I would point out that there are many of the contracts that do not have RCAF or many that have RCAF, but it is subject to an annual cap of 1 percent or 2 percent or it's 50 percent of RCAF. There are a lot of things that mean that we don't get pure RCAF on contracts.

VICE CHAIRMAN MULVEY: Would it be possible to tease out what percent of your increased revenues from the RCAF would be attributable to increased prices of fuel that would factor into it?

MR. JENKINS: I think that theoretically that's possible. It would be analytically quite challenging because we're dealing with, you know, several thousand contracts, but in theory at least, that's possible.

VICE CHAIRMAN MULVEY: Your statement unlike all other statements was one of the few that took on the rate versus practice debate.

MR. JENKINS: Yes.

VICE CHAIRMAN MULVEY: Or at least took it on from the standpoint of arguing that it was rate rather than a practice.

I'd like to explore that with you a little bit more hypothetically. What if a complaint is filed under 11701(a) in which the overall freight rate is not discussed unlike the previous cases that have just been cited? Only the mechanism for recovering the fuel component is at issue and that mechanism is found to be defective on its face.

If the railroad has alternative approaches readily available for recouping its increased fuel costs, (let's say mileage-based rates and let's say the one that's challenged is a rate-based surcharge) and if the Board finds that employing an across the board percentage fuel surcharge is unreasonable in light of the rail transportation policy, then is there a reasonable possibility or probability that the Board could strike down the fuel surcharges as unreasonable practices in your opinion?

MR. JENKINS: Well, I can't express a legal opinion on what falls within or outside the Board's jurisdiction, but I can suggest a couple of things. One is that I have been in the commercial side of CSX for almost 24 years. It's coming up on 24 years and in that period of time, I've been involved with hundreds of contract negotiations and as we got into the fuel surcharge era, it became very clear that this is one of the items that is part of the negotiation with that customer and the inclusion of a fuel surcharge in a contract may, in fact, change what the base is. It may change the term of the contract. It can have many, many implications that are linked directly to price or to other terms and conditions in the contract.

So, we find that separating the two as a practical matter is not consistent with what happens with our customers in our bargaining sessions.

VICE CHAIRMAN MULVEY: Let's take the demurrage rates and the demurrage rules. That would also be part of a contract. Correct? That clearly is a practice rather than a rate.

MR. JENKINS: In some cases, demurrage would be imbedded in the transportation contract. In many cases the demurrage is separate from the transportation contract.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN BUTTREY: I don't have any further questions.

VICE CHAIRMAN MULVEY: Thank you.

MR. JENKINS: Thank you.

CHAIRMAN BUTTREY: The next panel is from Norfolk Southern. Good afternoon, sir. Nice to have your here. You may proceed whenever you're ready.

MR. SEALE: Okay. Thank you very much. Good afternoon, Chairman Buttrey and Vice Chairman Mulvey.

It's good to be here and I certainly understand the interest in the hearing today. Everyone has an increased interest in fuel charges, the cost of fuel and the impacts on us individually as well as the economy.

I've got six basic points that I'm going to go through and I'll be glad to elaborate on these six points.

First, like everyone else, Norfolk Southern has struggled to really adapt to changing fuel cost and the price of oil. This is not a recent phenomena, but something that we've dealt with since 2000 and beyond that. It is something that we continue to look at and when we look at forecasts that

EIA and others have put out since 2000, it's very clear that no one had the clear forecasting capability to identify what crude oil or derivative prices would be in the next six months particularly starting in 2003. We had some relative stability of costs from 2000 to 2003, but from 2003 until today, it's very volatile.

Second, because of that volatility, Norfolk Southern has adopted three different versions of fuel surcharges since 2000. The original one in 2000. We modified that program again in March of 2004 and we announced a third modification April 24th to apply July 1st of 2006. We'll continue to look at the -- at the formulas to try to adopt what we see as a very volatile unpredictable situation.

Third, we're looking at the oil market like everyone else and I have to say that when I put my hat on in our company and I'm Executive Vice President and Chief Marketing Officer for the record for Norfolk Southern, I wish I could sit here and tell you that I predicted that type of freight demand that we're seeing today, that we saw in 2005 and that we saw in 2004. My hindsight is 100 percent, but my forecasting capability on that demand was not very good.

The same shortfall in terms of our forecasting capability came into play with respect to crude oil, but with that said, we're going to continue to monitor it and we will continue to modify our program as we go forward as we see fit in terms of the market itself and the cost of oil.

The fourth primary point that I want to make is that, and it relates to the forecast that I just mentioned, our traffic at Norfolk Southern continues to grow and it's grown since -- it's grown 14 percent since 2000, since the inception of our first fuel surcharge program against a low-tech industrial production growth rate of 1 percent.

So, as we have assessed fuel and we've assessed price together in the marketplace over that period of time, our demand numbers and our volume numbers show that we are competitive in the marketplace and the demand continues even today. In the first quarter of 2006, our volume was up 5 percent. It was up another 4 percent for 2005.

So, continuing demand and it appears that the combination of price and fuel surcharge is effective in the marketplace. It's value to the customer.

The fifth point is that we price to the market. We look at market factors in terms of determining our price for all of our services. Fuel is a component of that market price.

When I look at our fuel surcharge of Norfolk Southern, speaking just for our company, I see a three-legged stool. First is a partial cost recovery. The second leg is a market-based component that is brought about by negotiations in the marketplace and then the third is it reflects the efficiency of rail. The fuel surcharge has become a reflection of rail's competitive advantage in the marketplace vis-a-vis fuel efficiency.

So, all three of those factors converge into market-based pricing including fuel.

The sixth point is that we must continue to price for the market at Norfolk Southern to be able to enhance the capacity to meet the demand that we're seeing. Our capital budget this year is $1,146,000,000. At the end of this year and in a four-year hiring period we will have hired 8,000 employees. A 2,000 employee net gain to the company to handle additional business. We will have spent over $600 million on new locomotives.

All of that is to provide service and these six components are the crux of our fuel surcharge application in the market and we will continue to assess that going forward and do the best we possibly can to make sure that we're matching up total service with value.

Thank you very much.

CHAIRMAN BUTTREY: Thank you, sir.

Maybe you said this in so many words, but I'm asking every single witness that comes here if you could unequivocally state for the record that you're not over recovering your fuel costs.

MR. SEALE: Looking over the last six years since we've had a fuel surcharge, I can state that we have not over recovered over that period of that time. We continue to work on that. We've got 85 percent of our revenues now covered by some form of fuel surcharge.

The negotiation process is very prevalent in this area. There's a lot of variety to what has been put into place and over that period of time on direct diesel fuel, we have under recovered and then if we look at diesel fuel lubricants and gasoline, that number is larger with respect to the under recovery.

CHAIRMAN BUTTREY: Do you put a number on the under recovery?

MR. SEALE: Only on the direct diesel fuel expense starting at our $23 base.

CHAIRMAN BUTTREY: All fuel.

MR. SEALE: Yes, in 2000, it's $87 million and then if you take in gasoline, lubricants and diesel fuel combined and we all operate huge fleets of wheeled vehicles to support train service. That number climbs to $233 million.

VICE CHAIRMAN MULVEY: Getting back to this rate versus practice debate, is it accurate to say that in the Carolina Power and Light case that Norfolk Southern argued that the fuel surcharge was a separate rule rather than an element in the base rate and therefore, was not an issue in the rate case? Do you recall that?

MR. SEALE: I do recall that and I also recall that the other party in the case argued that it was part of the rate.

VICE CHAIRMAN MULVEY: People do change sides.

MR. SEALE: Well, you know, at the end of the day when we look at it, like I described it, the three-legged stool. It's difficult to pull off one leg of a stool and sit in it.

VICE CHAIRMAN MULVEY: Have you answered this? What portion of your traffic is not covered by fuel surcharges? Where you have contracts that preclude it or --

MR. SEALE: We estimate 85 percent of our revenue base is covered by some variation of fuel surcharge. Of some fuel and with respect to RCAF, what we have generally been doing is take a percentage out of RCAF before we apply some variation of fuel.

Most of that's in negotiation and the consummation of the deal that's done is part of that agreement.

VICE CHAIRMAN MULVEY: So, it's RCAF minus fuel. Then the fuel surcharge.

MR. SEALE: That's correct.

VICE CHAIRMAN MULVEY: So, you would argue that you're not over recovering from the fuel surcharge program? Not over recovering from double dipping as they say.

MR. SEALE: We do our absolute best to ensure that that does not occur.

VICE CHAIRMAN MULVEY: Let's see here.

CHAIRMAN BUTTREY: Thank you very much.

MR. SEALE: Thank you.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN BUTTREY: Our next witness is from Union Pacific. Good afternoon.

MR. KNIGHT: Good afternoon. We have a Power Point as well. Very quick here.

Good afternoon. My name Rob Knight. With me is Mike Rock from our Washington office. I am the Chief Financial Officer at Union Pacific.

During my 25-year career at the railroad, I have also held positions as Vice President and General Manager of both our energy and our automotive groups. I've had a chance to listen to both our customers and our shareholders which has given me a unique perspective on our fuel surcharge initiatives.

The Board has seen my written testimony and there's been a great deal of information discussed here already today. So, I'll just take a few minutes to summarize Union Pacific's key points.

Let me start with a very basic business principle. To stay in business and continue to serve our customers, we must generate enough revenue to cover the cost of doing business. This is as true for Union Pacific Railroad as it is for any other business in America and fuel is a major cost for Union Pacific.

In fact, we are one of the largest consumers of diesel fuel in North America. In 2005, we used 1.35 billion gallons of diesel. We paid $2.4 billion for that fuel and another $150 million in other fuel related costs such as utilities, gasoline, lubricants and other fuels.

As we all know, fuel prices have risen dramatically in recent years and higher fuel prices have clearly not been a positive for Union Pacific. Nobody likes high fuel prices. They are a tax on the economy and a tax on the national productivity.

We see the impact in our own personal lives as we fill up at the gas pump. When Union Pacific filled up at the gas pump last year, it cost us about 1.4 billion more in locomotive diesel fuel alone than it cost us in 2002. That's a 150 percent increase and a serious financial head wind to overcome.

Given the significant impact of higher fuel costs on our company, we have worked aggressively to reduce our overall fuel consumption. Since 2000, we have acquired nearly 2,700 new fuel efficient locomotives at a cost of over $3.5 billion. Last year, we started taking the first of 180 new hybrid low-emission yard locomotives and we've initiated several changes to our operating practices that have reduced fuel usage.

As a result of these efforts, we have improved our overall fuel consumption by 7 percent since 2000 while growing our traffic volumes by about 7 percent over the same time frame. Union Pacific does not consume as much fuel as it would without these efforts.

However, our fuel costs have continued to climb. Over the ten years between 1992 and 2002, our diesel fuel prices remained fairly constant averaging below 75 cents per gallon diesel. In 2002, it averaged about 73 cents a gallon and our fuel and utility costs made up only 12 percent of our total operating expenses. By 2005, that percentage had almost doubled to 22 percent of our total operating expenses. Diesel fuel averaged $1.77 per gallon last year and in 2006, is up around $2.20 a gallon diesel.

This rapid disproportionate rise in fuel price is what ultimately led Union Pacific to initiate our fuel surcharge program in 2002. It wasn't clear to us how long or how high fuel prices would rise, but it was clear that we needed to recover this huge and growing cost of doing business.

Our early attempts at a surcharge weren't very sophisticated, but over time, based on comments and suggestions from our customers, we've modified and improved the surcharge program. We've developed a process that, one, reflects the general fuel price trend, two is easy to understand and three is easy to administer for both our customers and for Union Pacific.

We've set the 75 cent per gallon UP historical average as our baseline. We've linked our surcharge program to the published DOE, on-highway diesel fuel index which is independently calculated and used widely within the transportation industry. This index is easily accessible and as you can see on the slide, is well coordinated and correlated to Union Pacific's fuel price.

Our goal has been to recover 100 percent of the incremental fuel costs above the baseline. We're not there yet.

In a perfect world, 100 percent of our incremental fuel cost would be recovered from 100 percent of our customers. In the real world, however, this has not been the case.

We are including fuel surcharge provisions in all new price documents. However, we have commercial relationships with some of our customers both large and small that have developed over time. Contracts already in place with these customers have prevented us from implementing a surcharge on their business thus far.

As fuel costs have risen dramatically over the past few years, our surcharge recovery has increased as well, but so has the amount of incremental fuel cost not recovered. As you can see on this slide as indicated by the green bar, since 2003, these unrecovered costs have totaled over $800 million, but we are making progress. In 2005, we recovered about 74 percent of the incremental cost. This year, we expect our surcharges to recover about 90 percent of the incremental fuel cost from about 90 percent of our revenue base. Much closer to our goal of 100 percent recovery.

In the first quarter of this year, our

total diesel fuel cost increased by about $150 million over the already high cost level of first quarter of 2005. Our first quarter surcharge recovery increased about 190 million year over year. This has caused some to conclude erroneously that we recovered more than 100 percent of our incremental fuel cost. This is just bad math.

In fact, in the first quarter of this year, we spent almost 400 million in incremental fuel costs above the historical 75 cent per gallon level. We recovered about 90 percent of that increment in the first quarter. This is about $190 million more than we recovered in 2005, but still less than the total incremental cost.

On the surface, the concept of a fuel surcharge seems fairly straightforward, but the deeper you get into the details, the more complex it becomes as we heard today. To actually determine the exact fuel cost incurred by every customer on each move would involve factors as we've talked all day including weight, distance, terrain, weather conditions, equipment type and other factors. This would be hopelessly complicated, enormously time consuming and administratively costly for both our customers and our company.

We've learned a great deal over the past years as we've worked with our customers and developed a better understanding of the surcharge process. In fact, as I mentioned, our current program reflects modifications from the original mechanisms in response to customer feedback. We're also learning from comments and suggestions generated by this hearing and there may be further modifications and improvements to be made.

In any event, it will be critical that our surcharge program enables Union Pacific to fully recover its cost of fuel. It must be responsive to customers. It must be equitable and still be easy to administer for both Union Pacific and our customers.

As I stated at the beginning of my remarks, Union Pacific must recover its cost of doing business if it intends to stay in business for the long term. Our customers are relying on us to be here for the future to meet their needs and invest for their growth.

By the end of this year, Union Pacific will have invested nearly $26 billion in its rail network since 1996. This includes nearly 2.8 billion in, excuse me, in 2006 and we expect to continue investing in the future, but we are relying on private investments in private right-of-way and we can only do that if our returns exceed the cost of that invested capital.

In recent years, Union Pacific has not earned a sufficient return to meet let alone exceed its cost of capital as our shareholders and our investors require. In fact, our return on investment in 2005 was only 6.3 percent using the STB methodology as indicated on the chart here which is well below the STB estimated cost of capital at around 10 percent.

Unrecovered fuel costs put additional pressure on those financial returns and impairs our ability to meet the increased demands for rail transportation in the years ahead.

The bottom line, Union Pacific isn't in the business of trying to make money from our fuel surcharge program. We're in the business of making a fair return by offering valued railroad services to our customers. In order to do this, to stay viable as a company and to reinvest for the long term, it is absolutely essential that our revenues cover our costs of doing business and that includes the unpredictable cost of fuel.

Thank you.

CHAIRMAN BUTTREY: The claim has certainly been made all morning that your company and others are making up their loss on their contract business, on their tariff business. What is your response to that claim?

MR. KNIGHT: I respond by saying that for Union Pacific in the first quarter and we expect for 2006 in total, our recovery above that threshold we expect to be about 90 percent and the total revenue base that will contribute towards that recovery also is 90 percent. So, there's still some business out there that we need to tap into as those contracts come to term and every new price document we put in place will have a fuel recovery, but our 90 percent recovery is being generated by 90 percent in aggregate.

VICE CHAIRMAN MULVEY: What percentage of your traffic is not covered by fuel surcharges because of contracts? Do you know?

MR. KNIGHT: Well, it would be roughly the remaining 10 percent that doesn't have some sort of --

VICE CHAIRMAN MULVEY: So, only about 10 percent --

MR. KNIGHT: Yes. Yes.

VICE CHAIRMAN MULVEY: -- is precluded.

MR. KNIGHT: And there's a variety of coverage rates within that 90 percent that does have some sort of fuel surcharge, but only 10 percent roughly would have nothing at this point in time.

VICE CHAIRMAN MULVEY: You know, I had heard that there were some contracts that were pretty long lived yet that still had these clauses in them and it would be long time before they could be renegotiated.

MR. KNIGHT: And that is true.

VICE CHAIRMAN MULVEY: Okay. How do you buy your fuel? Do you buy mostly wholesale or, you buy it mostly wholesale in bulk.

MR. KNIGHT: That's right.

VICE CHAIRMAN MULVEY: Of course.

MR. KNIGHT: Right?

VICE CHAIRMAN MULVEY: But you use basically a different -- you don't use the off-highway rate. You use the on-highway rate. Some argue that the off-highway rate will more closely tie to the actual rate that you pay for fuel for the base rate.

MR. KNIGHT: Right. I heard that today and, in fact, in our case, as I showed on one of my charts, the correlation between the DOE on-highway to the price that we actually pay is very well correlated and it's a very high correlation rate.

So, in our case, we think that correlation exists with the on-highway pricing. I can't speak to the off-highway. Is it a better type of correlation? Frankly, I doubt its any tighter, but perhaps that could be another way of looking at it.

VICE CHAIRMAN MULVEY: You began your testimony discussing the improved fuel efficiency of your locomotive fleet, a 7 percent reduction and improvement in fuel efficiency over the last 6/7 -- 6 years or so. Is that factored at all into your calculation of the fuel surcharge?

MR. KNIGHT: It is. When we look at establishing the rate that we're going to apply to the surcharge, we take into consideration what we actually are spending. So, the fact that we are doing things more fuel efficiently does go into the mix in terms of setting the rate.

VICE CHAIRMAN MULVEY: And finally, it's been argued that the RCAF might be a fairer way of calculating fuel recovery than using a fuel surcharge. Would you think that getting rid of the fuel surcharges and just relying upon RCAF would be a way of capturing the same proportion of cost that you are now?

MR. KNIGHT: Possibly, as you heard today, I think there's some adjustments that would have to be looked at with RCAF. The biggest one frankly is the lead time. I think as we talked today or spoke earlier, the RCAF is about 12 percent recovery and today our actual fuel expense is closer to 22 percent of operating expense. So, you've got that long lead time. So -- and there are other inherent issues I suspect that customers if they all are looking at RCAF might find across the entire spectrum of customers.

VICE CHAIRMAN MULVEY: Well, we adjust the weights periodically.

MR. KNIGHT: Right.

VICE CHAIRMAN MULVEY: We could adjust the weights again at a starting point for this and then, of course, fuel data from the AAR's available on a monthly basis and perhaps we could have a new RCAF which would come out monthly just reflecting the fuel and then one that comes out quarterly reflecting the other components, but --

MR. KNIGHT: I think one of the keys would be to be transparent and be something that not only the rails, but also the customer base could readily access and see in the marketplace and not something confusing that would be kind of a mystery to them as to how that was calculated and that's the beauty in mind of the DOE on-highway diesel fuel prices. An index that is readily available. It's not railroad owned or railroad generated. It's out there for everybody to see and there's no debate over what that number is.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN BUTTREY: There was a lot of testimony this morning about the difference between what grain shippers pay and what coal shippers pay. The grain shippers testified that they were getting a much worse deal if you will than the coal shippers are. I wonder if you have any response to that.

MR. KNIGHT: I don't. We assess our fuel surcharge as a percentage of rate. So, that particular argument I think applied to more of mileage-based rate. But, I think one of the comments that was made earlier which I think is a true statement is that with coal you are generally talking about unit coal trains made up of all that business moves and efficient use of coal trains.

CHAIRMAN BUTTREY: But, aren't you also talking about unit trains when you're talking about grain?

MR. KNIGHT: Well, with grain you have a

large portion of your unit train business, but you have other business in the grain markets that doesn't move as efficiently in unit train business. You have shuttle trains and even smaller cuts as well. So, I don't have a strong opinion in terms of the differences between the ag and the coal markets.

CHAIRMAN BUTTREY: Questions.

VICE CHAIRMAN MULVEY: No. Thank you.

CHAIRMAN BUTTREY: Thank you very much.

MR. KNIGHT: Thank you.

CHAIRMAN BUTTREY: We were conferring about what our schedule would be and we're going to take the next witness. Then we're going to take another 15-minute break. Then we'll come back and have the consultant panel.

So, see you when you're ready, sir.

MR. DINGMAN: Good afternoon. My name is Robert O. Dingman, Jr., President of the Oil Creek and Titusville Lines.

The Oil Creek and Titusville Lines are the short-line railroad in Northwest Pennsylvania operating on 16 miles of leased track between

Rossville and Titusville, Pennsylvania. Oil Creek and Titusville Lines has a junction settlement carrier relationship with Norfolk Southern and its predecessor Conrail since 1986.

Mr. Chairman, Mr. Vice Chairman, valued shippers trade association members, rail consultant and colleague railroads, allow me first to state that Oil Creek and Titusville Lines has no fundamental disagreement with the surcharge as a method of recovering dramatic unpredictable and material increases in fuel and other costs. The imposition of a surcharge is far better than the destruction of service quantity or quality to prevent the failure ofa carrier's enterprise.

However, since the tariff contract or exempt quotation is frequently adjusted every six to 12 months in our experience and it may contain an RCAF adjustment provision, the surcharge should be related only to those price changes which are, in fact, dramatic, unpredictable and in excess of the contractual mechanisms’ ability to make the carrier whole.

The surcharge must not continue to be used to enhance a carrier's profit at a time of tight capacity and unusual traffic demands. This goes beyond being a mere misnomer and is in our opinion an unreasonable practice.

As we understand Norfolk Southern's most recent public announcement, they appropriately recognize the foregoing. Furthermore, they realize that the index they use for calculating the surcharge must be contemporaneous with the time frame for which the quoted price was to be in effect. Hopefully, in addition, they recognize that our shippers may not operate in a protected franchised environment such as that which the railroads enjoy. Thus, the shippers cannot pass on costs as easily and therefore, profiteering through an exorbitant fuel surcharge is unnecessarily and unwisely beating up on our shippers.

Finally, all billing carriers have the right to adjust their cost recovery methods on through rates, but they must divide the additional revenue amongst all carriers in the route who have participated in the rate making. To do otherwise is profiteering by the billing carrier at the expense of the carrier which actually incurred its share of those increased costs, but did not receive its rightful revenue from the surcharge.

This is the status of the current relationship between Oil Creek and Titusville Lines and Norfolk Southern despite our numerous and repeated attempts to rectify this unfair arrangement with them.

This practice is an unreasonable practice designed either to coerce Oil Creek and Titusville Lines as a short-line carrier into a new and different accounting relationship which is not in our best interest or to profit Norfolk Southern as the collecting carrier by recovering funds as a fuel surcharge on fuel they did not burn.

Conclusion, in either case, Oil Creek and Titusville Lines respectfully ask the Surface Transportation Board to redress this unreasonable practice upon complaint.

Thank you for your time and for your attention to this important matter.

CHAIRMAN BUTTREY: Thank you very much,

sir.

VICE CHAIRMAN MULVEY: Norfolk Southern then enforces fuel surcharges on traffic that you originate and terminate and --

MR. DINGMAN: That's correct.

VICE CHAIRMAN MULVEY: -- they share none of those increased fuel costs with you?

MR. DINGMAN: That's correct.

VICE CHAIRMAN MULVEY: And that's because you negotiated that in your contract with that? You agreed to that in your contract or --

MR. DINGMAN: No, we did not agree to that in the contract.

VICE CHAIRMAN MULVEY: That's just --

MR. DINGMAN: Norfolk Southern deals with the handling line connecting short lines which is a class of accommodating arrangement that they have. I understand that they share and have a mechanism to share fuel surcharges with those carriers.

Oil Creek and Titusville Lines is one of three or four junction settlement carriers that were with Conrail that are now with Norfolk Southern and as

I understand it, those that have not converted do not share in any fuel surcharge.

I see no reason why since we participate in the rate making, since we burn the fuel that we're not eligible to participate in that.

Regardless of the level or the method of calculation on the surcharge, if it is applied to the rate and the rate applies to the entire rate, goes through route, then we are entitled to it and I think that this is prima facie if you will evidence that it is an unreasonable practice, very small, affecting a very small railroad, but it is unreasonable.

The fact of beating up on our shippers is a point which I make to say that if we're going to increase prices dramatically in a time of tight capacity, we have to step to the plate when we negotiate the rates and say so.

In my opinion and I've sat here and listened to the presentations that have been given so eloquently by my good colleagues, they have used the fuel surcharge as a quick way to profit from the tight capacity to raise a lot of money.

Appreciate that. Whether it's right or wrong, I leave to others, but I want our share.

VICE CHAIRMAN MULVEY: You sound suspiciously like somebody else in the railroad business who I won't mention right now, but is always looking for share for all his constituents.

What if you were to just convert to the other accounting system? Would that be terribly burdensome? It would give you the right to --

MR. DINGMAN: It doesn't give you the right to participate in setting and negotiating the rate. You present to Norfolk Southern a category of rate work, a broad category of commodities. We like to be able to find, negotiate rates with the class ones that connect for new customers. We've been successful at that. We have published the rates because we can do it quickly when Norfolk Southern and the other connecting carriers give us permission to do so.

So, we do this as a form of active marketing. We think that the handling line status disrupts that ability.

Now, I might say we have another railroad that I own, New York and Lake Erie Railroad that connects with CSX at Buffalo among others and CSX has many junction settlement carriers and they do automatically divide the surcharge revenue with those carriers. So, they have no issue.

VICE CHAIRMAN MULVEY: Okay. Thank you.

CHAIRMAN BUTTREY: Thank you very much, sir.

MR. DINGMAN: Thank you.

CHAIRMAN BUTTREY: We'll take a 15-minute break.

(Whereupon, at 4:27 p.m. off the record until 4:45 p.m.)

CHAIRMAN BUTTREY: The last panel this afternoon will be Escalation Consultants, Inc., Snavely King Majoros O'Connor & Lee, Transportation Economics, Inc., Highroad Consulting, Ltd. and Freight Resources Network, LLC.

Thank you very much for coming today. We're anxious to hear what you have to say. Thank you.

You may proceed.

MR. ROMAN: Chairman Buttrey, Vice Chairman Mulvey, my name's Jay Roman from Escalation Consultants and I once again appreciate the opportunity to present to the Board.

My written testimony in this proceeding dealt with all the differences there that make the fuel surcharge program very distanced from the actual fuel costs that railroads incur and the analysis that we've done of railroad fuel surcharge programs demonstrates that those differences are contributing to the railroads' recovering more than their increase in fuel expense.

But, after sitting through this hearing all day, I can appreciate the difficulty of the Board because you have shippers and consultants up here saying that the railroads are over recovering and you have the railroads saying boy, we're not recovering enough. We need to get more.

My testimony's going to try to simplify this issue and to do that, I'd like to start with really how fuel surcharges work.

Fuel surcharges are applied against the total revenue for a movement. They are applied against rates and the reason they're applied against rates is to generate an amount of revenue for the railroad to cover their increases in fuel expenses. So, you have fuel surcharges applied against rates to accumulate money for the railroads to cover expenses. So, this relationship between fuel expenses and then revenue is extremely important because that's what these surcharges do. They're applied against the revenue to cover expenses.

I'd like to focus my testimony on what is happening with the railroads as far as this relationship of fuel expenses in relation to revenue, what it was back before these fuel surcharges were actually generating any revenue and what it is now. You see if the railroads are in a better position right now with fuel costs as a percentage of expenses than they were back in the 2001 time frame when these surcharges weren't really generating any money.

And to do that, what I'd like to do if this button works -- here I'm looking at Norfolk

Southern and in the fourth quarter of 2001, fuel costs as a percentage of revenue were 6.27 percent. Just dividing fuel expenses by their revenue.

In the fourth quarter of 2005, I'm doing a comparable calculation. Only during this time period, if you actually calculated their fuel expenses divided by revenue, you would get a percentage below the 11.68 percent I have there. Because what I am solving for is what fuel expenses would be as a percentage of revenue to the railroads without any fuel surcharge revenue.

So, what I'm doing with the revenue in the fourth quarter of 2005, I'm saying okay, let's get rid of any revenue associated with fuel surcharges and to do that, I'm deflating their revenue by their average fuel surcharge in the fourth quarter of 2005 which is 16.7 percent. I am lowering their revenue.

CHAIRMAN BUTTREY: This is coming right out of the financial statement?

MR. ROMAN: That is correct.

CHAIRMAN BUTTREY: Public documents?

MR. ROMAN: Public documents.

CHAIRMAN BUTTREY: Okay.

MR. ROMAN: Now --

CHAIRMAN BUTTREY: We may stop you, every one of you, in the middle of this because we're not going to do your questions like we normally do. So, the rest of you can be ready for questions at any time.

MR. ROMAN: Would appreciate it.

CHAIRMAN BUTTREY: Good.

MR. ROMAN: The 16.7 percent I'm deflating their revenue. When I divide this lower amount of revenue into the same expenses, the percentage increases of fuel expenses as a percentage of revenue.

So, when I go between the fourth quarter of 2001 to the fourth quarter of 2005, I show the fuel expenses as a percentage of revenue increased 5.41 percent. Now, what that 5.41 percent represents it is the amount that if you apply it to the railroad's revenue in the fourth quarter of 2005, they would be no better off and no worse off as to fuel cost as a percentage of revenue than they were in the fourth quarter of 2001.

This 5.41 percent is substantially below their 16.7 percent fuel surcharge. The difference is 11.29 percent. What I have entitled that is recovery above fuel costs because if they recover 16.7 percent on all their revenue, they would be in a better position in the fourth quarter of 2005 than they would be in the fourth quarter of 2001.

Now, from analyzing all these surcharge programs, what we find is that when these programs were initiated, you had a price per barrel of oil of $23 or $25 per barrel and maybe there were some problems associated with these programs then, but they were very small problems. But, as oil prices went from $25 to $30 to $40 to $50 to $60 to $70 per barrel, these small problems have started to accumulate to be larger problems and what we find through the analysis that we've performed of the railroads is that recovery above fuel cost has increased over time as the price of fuel's increased and the --

CHAIRMAN BUTTREY: Well, it's like compound interest.

MR. ROMAN: If you have a problem with low oil prices, it compounds and becomes a bigger problem with high oil prices. Yes, sir.

CHAIRMAN BUTTREY: I will just ask another question while we're waiting.

MR. ROMAN: Okay.

CHAIRMAN BUTTREY: All right. You've used NS as an example here.

MR. ROMAN: That's correct.

CHAIRMAN BUTTREY: Is it safe for us to assume, I mean the Board to assume that those numbers to some extent approximate the numbers that would be true for the other carriers or is this unique in some way that would keep it from being very similar to the other carriers?

MR. ROMAN: In my testimony, I'm going to be giving the calculation of recovery of all fuel costs for all the major U.S. and Canadian railroads.

CHAIRMAN BUTTREY: So, you're going to give them all.

MR. ROMAN: -- I will take Norfolk

Southern through the total time period and then I'll give the results for the other railroads.

CHAIRMAN BUTTREY: Okay.

VICE CHAIRMAN MULVEY: When you were doing this fuel, your revenues by the fuel surcharge, you calculate the total fuel surcharge against the total revenue?

MR. ROMAN: I'm simply taking their revenue and I divide it by 1.167 percent to deflate by assuming that everyone is getting that fuel charge and deflating the revenue.

VICE CHAIRMAN MULVEY: You're assuming that everyone is paying the fuel surcharge.

MR. ROMAN: That is correct. But, you --

VICE CHAIRMAN MULVEY: But some are over paying it?

MR. ROMAN: But, if everyone is not collecting, this percentage of 11.68 percent would actually be lower. So, the over recovery would be greater because I wouldn't be deflating it by as much.

VICE CHAIRMAN MULVEY: Okay.

MR. ROMAN: Okay. This graph is showing

over time what our calculations are for Norfolk Southern. The blue line with the box on it is simply -- excuse me, the green line with the diamond on it is showing what Norfolk Southern's fuel surcharge is each quarter between the fourth quarter of 2001 and the fourth quarter of 2005. Just putting out there what their surcharge is.

This bluish line with the box on it is called recovery above fuel cost. I've gone through the same calculation I had in the previous illustration each quarter for Norfolk Southern and tracked it against the fuel surcharge.

Now, from an analyst standpoint when you look at a graph like this, the first thing you say is I better go back and check my numbers. Because this is essentially showing that recovery above fuel costs and the way I'm calculating it here is pretty much the same as the railroad's total fuel surcharge out through the latter part of 2004.

When you go back and you check the numbers for why that's happening, this is what you find. I've added a line to this graph. It is this green line with a diamond on it. This line is reflective of the fuel cost as a percentage of revenue. It is this calculation. What is fuel cost as a percentage of revenue and it's showing that when you divide revenue into fuel cost each quarter, it didn't really change for Norfolk Southern until we got out to the year of 2005.

So, if fuel cost as a percentage of revenue hasn't changed, then it's a question of what is the fuel surcharge? Well, what I've entitled it here is recovery above fuel cost.

Now, I think it's kind of interesting to talk about this line right here, fuel cost as a percentage of revenue. Why would that be staying the same over this whole time frame? We've heard lots of testimony in here today about some of the reasons it would stay the same.

Railroads use hedging. I mean they try to minimize the upward increases in fuel costs that they're subject, too. They institute policies and procedures. When fuel costs go up, you try to use less fuel cost. Try to buy more fuel when it's low and buy less fuel when it's high.

But, you also cannot ignore the fact, another thing would keep fuel cost as a percentage of revenue the same, is if the railroads are recovering a lot of their fuel costs in their rates. Because when you divide fuel cost by revenue the higher the amount of revenue, the more rate increases they get, the more downward pressure there is on this calculation of fuel cost as a percentage of revenue.

It's simply long division. The higher the denominator, the lower the result that you're going to get and in this case, we have fuel cost as a percentage of revenue not changing out through the latter part of 2004.

Now, when we look at this for the other major U.S. and Canadian railroads, all these numbers here are based on -- as if the railroads had the carload fuel surcharge for all of their movements. Which isn't really going to be the case.

All these changes represent what's happened between the fourth quarter of 2001 and the fourth quarter of 2005 just like the illustration I put up first with Norfolk Southern and it shows that Canadian Pacific had the highest revenue recovery above fuel cost at 12.1 percent. Well, we know Canadian Pacific revised their fuel surcharge in January of 2006. So, they'll no longer be the highest one here as we come out to the next quarter.

The lowest one here is Union Pacific with a revenue recovery above fuel cost at 1.8 percent, but I have to preface. The western U.S. railroads, here it would be wonderful to have some additional information here to true up these calculations. Because we have calculated all this revenue recovery above fuel cost based upon their carload surcharge program.

As it was stated here today, their fuel surcharges for instance for coal are much higher than they are under the carload program. As an example, in December of 2005, the surcharge program for coal was about 7 percent higher than their carload fuel surcharge program. So, as we get actual numbers from the revenue for the actual fuel surcharge revenue they collect, we'll true these things up. We think this lower over recovery numbers here will probably increase.

But, I'd like to talk about going out into the future and recommendations.

The way fuel surcharges are applied, they're applied against revenue to get an amount of money to cover fuel expenses. This is a very relevant calculation to be determining how these surcharges are actually performing and what we would recommend that they submit the following information to the STB to help the STB better understand what is actually happening here. To submit their total fuel expense. They already do these types of things. Their total freight revenue. The revenue collected from all their fuel surcharge programs.

Calculation of fuel cost as a percentage of revenue and by that I mean total fuel expense divided by total freight revenue less fuel surcharge revenue and then we'd request that they submit these calculations quarterly for the previous four years.

Now, what this will do, what the

advantages of this are is it would provide an easy to use measure that enables the Board and other interested parties to evaluate whether a railroad's fuel surcharge program is reasonable. I think the Board needs to have something. We've been talking here all day and we have a tale of two cities in this room. You need to have data that you can really evaluate how these programs are performing.

It requires minimal added reporting by the railroads. They already submit most of this information. The information we're really interested in is the revenue they're recovering from their fuel surcharges. It would provide a method for eliminating the four years of fuel escalation railroads are currently receiving under their current fuel surcharge program.

I envision this could be used as an index. You could have an index for each railroad where you could be taking a current rate and you could be adjusting it by this index which would be reflective of how effective this program actually is.

Last, but not least, this is a very

relevant calculation for fuel surcharges that are applied against the rate for a movement. Being as these surcharges are applied against revenue to generate an amount of money to cover expenses, these calculations are probably one of the best ways of determining how these surcharges are actually performing and how closely related they are to the railroads' actual changes and cost.

We've heard a lot of different numbers in here today and I think it would be important to focus on the bottom line as to how these programs are actually performing.

That concludes my testimony. I thank you for once again being able to present to the Board.

CHAIRMAN BUTTREY: Thank you. Thank you very much.

(Whereupon, at 5:00 p.m. the evening session began.)

E-V-E-N-I-N-G S-E-S-S-I-O-N

5:00 p.m.

CHAIRMAN BUTTREY: Tom, go right ahead.

MR. O'CONNOR: Okay. Thank you. Good to be here today. Thank you, Chairman Buttrey, Vice Chairman Mulvey, staff.

My name's Tom O'Connor. I'll be summarizing highlights of the presentation that Kim Hillenbrand and I submitted as testimony and we're going to come to a similar conclusion that Jay offered you just a few minutes ago.

What we were hearing today is a fairly easily solved problem and it's solved by the availability of the data.

We'll conclude with a recommended action plan and the recommended action plan spells out the data that we believe would solve the problem that is before you today.

We are testifying in conjunction with the American Chemistry Council. This slide reiterates some of the points made by Tom Schick in his earlier testimony and I'll just expand on one or two of those as we go through.

We talked a little bit about how would fuel surcharges be properly applied to specific movements and point of fact, in Canada, they have used off and on since 1926 a formula called the Davis formula which takes account of things which you heard from one of the witnesses earlier today. Takes into account speed, weight, distance and the like. It's an engineering kind of an approach to the problem.

But, what that concept is speaking to is the fact that it's a useful approach and we have it included in our testimony and in our recommendation to link to a service unit and which exact service do you link to and how you link to it remains to be debated. But, linking to it is important.

Fuel surcharges lack transparency. The data collection will solve that problem. It will solve that problem.

Now, in the course of the day, I'm not sure I recorded every recommendation for solving the lack of transparency, but I heard it from auto, coal, lumber, a few more shippers. I heard it finally from

UP. UP wanted something that was transparent.

The class one railroad fuel surcharges all share a fatal flaw and the fatal flaw you heard about earlier today and you've heard about it from practically every shipper with us. The flaw is we're applying a cost increase percentage to a revenue factor. We're really doing a pricing when you take that approach. That's differential pricing not cost recovery. It's differential pricing.

When we are going to apply revenue as the base, we recover costs differently among commodities. That's a rate problem.

We recover costs differently among industries. That's a broader problem.

And ultimately, we over recover fuel costs and we'll probably over recover fuel costs on all of the movements that are exhibiting a revenue cost ratio greater than the average for the year, roughly one -- you might even be over recovering fuel costs for everything that's got an RVC greater than 100. So, you are definitely over recovering differentially.

Now, the class one railroads' fuel

surcharge is similarly flawed. We're looking at five of them. U.S. ones doesn't go forward and they all share that same flaw.

This graph indicates part of the reason why the railroads might resist the use of RCAF. What are we looking at here? We're looking at fuel cost as a percentage of operating cost.

Notice two things here. First of all, the fuel cost as a percentage of operating cost varies significantly among the railroads and it varies significantly within a railroad through time.

The RCAF weights that you heard about earlier today will be stable in terms of, at a given time you'll have the same weight per fuel for all of the applications of the RCAF whether adjusted for productivity or not adjusted for productivity for all carriers, all shipments. What you're looking at is the fact that fuel impacts them differently. Okay.

Now, this graph also shows you one thing, too. It focuses on the annual changes in fuel costs and we'll take a look at those on the next graph.

Here's the 2005 average fuel surcharge

compared to the 2005 change in fuel cost. Now, the difference between those two parameters is a rough measure of over recovery. You can see that all of them by this measure are over recovering. The source of this data parenthetically are the railroads' SEC filings on the company websites and it jumps right out at you. This data should be available to the STB and much of it already would be available reported in some format to the STB.

VICE CHAIRMAN MULVEY: Tom, why would the change in fuel cost be a percent of total cost instead of just the percent change in fuel cost? The total cost would also increase. Wouldn't it? And that wouldn't lower the change in fuel cost as the percent of total cost and would other costs increase also?

MR. O'CONNOR: Yes, total cost can be moving during that same time period, but what this is telling you -- we're back on the previous line. What this is telling you is that as we move from 2004 to 2005, fuel really got to be a serious problem and looking at the NS, we looked at NS in Jay's data, but NS in 2005, fuel was roughly 11 percent. NS is not doing too bad when you have an RCAF that's at 12 percent, 10/12 percent. But, 10 or 12 percent is not going to be welcomed by BN for whom fuel is 19 percent nor UP for whom fuel is 20 percent.

That's the kind of a problem that you get into with the RCAF. As long as RCAF stays as a national figure, this is kind of a structure problem here.

There is another thing, too, to bear in mind. There is an all inclusive index less fuel. The all inclusive index less fuel until fairly recent years, I want to say partway through 2004, 2005 and beyond if you graph it and we don't have this particular graph in this particular presentation, but if graph it, you'll see that the RCAF less fuel and the RCAF including fuel track very closely together.

In 2004 and certainly in 2005 and beyond, they begin to diverge. When they begin to diverge, this kind of a problem with fuel and fuel cost recovery is going to be a typical problem that you're going to be hearing about from both railroads and shippers. It's a structure problem.

Okay. Now, this graph we just looked at. Let's go back to page four. Just take a quick look at page four and now, let's go to page six. That's the difference in cost. This is the fuel surcharge. It is utterly impossible for that cost difference to be run against this fuel surcharge uniformly and somebody is not recovering a different amount. That's mathematically impossible.

Now, the fuel surcharges claimed by BN and UP are virtually identical. The fuel surcharges claimed by KCS, NS and CSXT are also virtually identical. There is, of course, a difference between the eastern carriers and the west and the KCS joined the eastern carriers in roughly the end of 2004. But, that's an amazing graph.

Here is what we were able to piece together and Kim gets most of the credit for coming up with this data. This data was pieced together out of SEC filings. This data should be available for every railroad at the period that you want and when you have this data available, all of the ambiguities and uncertainties about whether there's an over recovery or an under recovery will disappear.

We take line one the 2005 fuel costs, line two the 2004 fuel costs, line three is simply the difference. That's the increase in fuel costs as submitted to the SEC. It really should be submitted to STB. That's the increase in fuel costs. That's the amount that one would expect a surcharge to recover.

Some of the railroads, BN and NS and UP, we were able to identify an amount of fuel surcharge revenue that they reported. Most of this is direct. Some of it came indirectly through Wall Street analyst reports. It should be coming from the STB. This is a simple piece of information and with this piece of information, all the ambiguity goes away. You've got the facts. You've already got the principle. Then you'll have the facts. Then you're there. That's all.

Okay. The next slide, I would submit that the class one railroads' fuel surcharge structure is unsupported, certainly unsupported on data that's been provided or that we've been able to come up with or we heard here today and it appears to be structurally inequitable. I would submit further that that practice is almost by definition unreasonable.

Similar shipments transported in the same train can and do have vastly different fuel surcharges. We submitted that in evidence. No need to dwell on it here. Anybody could come and replicate that same analysis. You would get exactly the same result.

Central city to central city, different commodities, different revenue, different fuel surcharge. Everything else is the same.

Here's the plan that we would recommend for your consideration. First, require uniform railroad reporting of railroad fuel costs. Not a big deal. They're copying it. It's there.

The relevant fuel surcharge measure is the change in fuel cost. Not the total, but the change and the definition of the base period becomes critical. It is definitely not 2001 as we heard a couple of times here today. It is not 2001.

For both the base period and the

subsequent period, fuel cost will be related we'd recommend to a simple and readily measured service unit. Revenue ton miles comes to mind. There are lots of others that could work.

But, railroads would also report the actual fuel surcharge revenues they collect during each period and they would distinguish, this is important, they would distinguish the non-fuel surcharge traffic from the fuel surcharge traffic so we wouldn't be guessing about it.

Now, where did I get that idea? I got that idea from the announcement that CSX made in 2000 when they announced their first fuel surcharge and it was authored by our current Secretary of the Treasury who was then President of CSX. But, that's his idea.

I think it's a good idea and he said that was the way he would apply the fuel surcharge. He would not apply a fuel surcharge to traffic to which is should not be applied. He defined as part of that traffic RCAF traffic, RCAF suggested traffic, traffic that had a contract.

Then we go to step five, comparisons of

the fuel cost incurred and the fuel revenues received becomes a simple matter of arithmetic. Whether you have an overcharge or an undercharge, you can then correct it in the following period be that a month or a quarter.

This is very similar to the RCAF forecasting adjustment that is automatic. I mean they do their best at the RCAF forecast and as you know from looking at the RCAF forecast, that it's never been right. I don't think there's a single quarter it's ever been right in its history. That's the way forecasts are.

So, you have an adjustment once you got the actual data. You look at the actual data and you apply a forecast correctly.

That is our recommendation and we appreciate the opportunity to be before you and we may have even finished close to on time.

Thank you. Kim is the coauthor of this. He's allowing me to speak here, but he's the coauthor.

CHAIRMAN BUTTREY: Thank you very much.

MR. O'CONNOR: Okay.

MR. ALI AWAN: Good afternoon, Chairman Buttrey and Vice Chairman Mulvey and Board staff members.

The view is quite different from this side of the dais I must say and it's good to see you all again.

CHAIRMAN BUTTREY: It's good to see you, too.

MR. ALI AWAN: Thank you. As you know, my name is Mazhar Ali Awan and I am a Managing Director at Transportation Economics, a consulting group that assists electric utilities and other shippers to understand how transportation and regulatory issues affect their businesses.

Aside from litigations for it, Transportation Economics has helped shippers with plant studies, cost analysis for various rail movements, project feasibility analyses and other types of economic research and forecasting.

Much of what I wanted to cover today has already been covered by other speakers. So, I'm going to leave out a lot of that portion and yield back the balance of my time.

Let me start by saying that railroads are entitled to cover their fuel expenses. I don't think a single shipper today has said to the contrary. Moreover, railroads should be free to bear as much or as little risk as they want with regard to changes in fuel prices.

Traditionally, railroads have accomplished this through at least three different mechanisms. The first one escalation clauses and contracts, hedging programs and the third one being fuel surcharges.

Escalation charges are based on some factor of real cost and allow railroads to recoup fuel expenses. Of course, if prices drop, the savings are passed along to the shippers.

Hedging inevitably raises the expected fuel price. There is a cost to be paid for the benefit of smoothing out price volatility.

In addition, any hedging program carries with it a small, but a very real risk of a rogue trader. A trader that guesses wrong and then doubles up his bets and potentially single handedly wipes out the firm.

Hedging programs used in conjunction with fuel surcharges are more worrisome and really are double dipping, but actually, the more you think about it they're really triple dipping or a triple recovery of fuel expenses.

Ideally, a hedging program would be effective or prudent only where a carrier did not have recourse to adjusting rates to accommodate added fuel expense.

I've traveled much in the last year since leaving the Board, year and a half since leaving the Board and aside from service concerns, the biggest concern that shippers have had throughout the country has been the fuel surcharge expense that they've been forced to bear.

I think the questions that the Board really needs to ask itself and the shipping community and the railroads are what is a proper fuel surcharge? Two, under what circumstances would a fuel surcharge become an unreasonable practice and three, what can the Board do to facilitate private sector initiatives to develop an appropriate fuel surcharge mechanism?

Let me begin by saying that a fuel surcharge ought to be a pass-through mechanism of additional fuel expenses and that's unexpected changes in fuel expenses. So, surcharges that capture more revenue than the totality of a movement's fuel costs are really not a surcharge.

An appropriate fuel surcharge is a pass-through mechanism not a call-back mechanism. A mechanism that captures more revenue than the change in fuel price is implicitly and surreptitiously a rate increase.

An appropriate fuel surcharge should capture the change in fuel prices from a common starting point. It makes little sense to ask the shipper who's built a new plant to pay a 15 percent fuel surcharge when they haven't moved anything yet.

Stepping back for a second, I think this whole problem with the fuel surcharge and the reason why you hear so much outcry about this and concern from both the railroads and the shipping community is really an information asymmetry problem.

The Board can very easily change this. There have been other shippers during the day who recommended that we go to SEC filings and various -- and require the railroads to file additional data. I don't think that needs to be really done and I'm going to explain that more fully in a minute.

The Board requires the railroads to file R1 statements every year and in those R1 statements is a category for fuel expenses. So, the Board already has the data it needs to determine what the fuel expenses for the various railroads have been for the previous year and the Board processes these R1 statements that the railroads submit into its uniform rail costing system, the URCS costing system, and the data exists within the Phase II part of the URCS costing system.

Now, the Board can very easily change its asymmetric problem by tweaking the Phase III program which the Board sells to all interested parties at a nominal expense. I think it's $50. So, there's a plug for the Board's IT department, and really change the dynamic of what people are talking about out in the industry.

So, with these changes in the URCS system that we've proposed and which I'll explain a little bit more in a minute, this information will allow shippers to really assess the surcharges that they believe are either onerous. They can use this information to find out that, in fact, they are reasonable and at the same time, the carriers can use this data to determine whether their fuel surcharges are too high and effectively, they would have to explain to the shippers why their fuel surcharges are so high.

So, it really changes the dynamic of the conversation going on in the private sector by providing the industry more information.

Now, in my written statement, in Transportation Economics' written statement, we have enunciated five principles that the Board should employ in assessing fuel surcharges and I won't repeat those here in the interest of time.

What I did want to do was I know that Tom did an excellent job showing you the macro level of the effect of fuel costs on railroads and the surcharges that they've imposed and the difference between the two and I think in keeping with the national rail transportation policy which really states that the Board should allow the private sector to function as much as possible on its own without interference from the Board, we really need to look at a micro analysis to see which shippers are really being affected and how do we remedy those particular instances.

Transportation Economics was asked by Highroad Consulting to apply URCS to nearly two dozen movements to isolate fuel cost associated with these movements and to compare these expenses to fuel surcharges applied to these shippers and we did this and we required -- we did not require -- we didn't have to go to the SEC filings to get this data. All we did was look into the URCS figures that the Board reports at the end of the year usually around September every year for each of the rail carriers.

And if you look through the URCS tables and they're voluminous, almost 400 pages per railroad, you can go through the tables and you can find the unit cost associated with each one of the elements that one would think would contribute to fuel expense and those elements are actually identified in the URCS program through the regression equations that are used by URCS and rightfully, gross ton miles one would think would be a very important factor in determining fuel cost as would locomotive running miles and if you keep going through once you find those two variables, you find that there is yard switching and road switching that also contribute to fuel expense for the railroads.

And basically, that's what we did. We got the unit cost for the gross ton miles, the unit cost for the locomotive running miles and switching that would be associated with these particular movement that we analyzed. We added a gross overhead ratio to that and used the movement characteristics developed using URCS and we got very interesting results.

The exact model that we used is included in our written testimony.

I would note that there really is not

reason to use West Texas crude or the highway diesel cost or any of these other indices because this information exists within URCS. So, why not use the Board's costing methodology or the costing data that the Board already has to figure out where we are with respect to fuel cost or fuel surcharges.

Essentially we assume the URCS regressions that fuel expense was based on trailing weight, the number of locomotives used in the movement and the length of movement. In our analysis, we found that the cost for each of the shippers that we studied they were paying fuel surcharges that exceeded the total fuel expense developed using URCS Phase II and Phase III data and movement characteristics. That's the total fuel expense.

Stated differently, the fuel surcharge itself was greater than the total fuel expense for the movement, while the base rate already includes a component for fuel within that rate. In fact, these fuel surcharges often exceeded by several multiples the total fuel cost estimated by URCS. We're just talking about the fuel surcharge now.

CHAIRMAN BUTTREY: What was the order of magnitude of that difference?

MR. ALI AWAN: It varied from if I remember correctly 75 to 200 percent. Is that correct? Okay.

I also wanted to mention that railroads should not be allowed to turn to non-contract shippers to cover the cost of fuel associated with long-term contracts that do not possess pass-through mechanisms.

Now, the Board on the stand alone rate case ties has been very concerned with cross subsidy concerns and it should be concerned with this I think on this factor, too because this practice should be considered a cross subsidy. An impermissible cross subsidy.

Concluding, the Board asked in the notice for the hearing that the shippers show that railroads were labeling a rate increase as a fuel surcharge and to show when a rate increase is not directly or closely correlated to increases in cost of fuel for a particular movement to which the surcharge is applied.

Our empirical research into this inquiry shows that the movements that we analyze, the recovery of fuel expense was, in fact, greater than the fuel cost incurred by the respective originating and terminating railroads.

The Board also asked how the reporting requirements of the railroads should be adjusted to provide rail customers with better information on a carrier's fuel costs and the revenue collected through fuel surcharges. We agree with the railroads that the answer to that is the data is already collected and exists in a usable form within URCS.

The Board simply needs to add a data output in the phase three process to show what the fuel costs are for the movement that has been analyzed.

The railroads have testified that developing fuel costs for each of these thousands traffic would be onerous. This is not the case. URCS could be used as a tool by shippers to determine what their fuel expense is for each of their movements and they could use this data to negotiate with the railroads. This would go a long way in giving shippers the needed information to assess fuel surcharges made by railroads as reasonable or unreasonable.

CHAIRMAN BUTTREY: Excuse me. Your time is up. So, if you could just briefly sum up.

MR. ALI AWAN: I have --

CHAIRMAN BUTTREY: Maybe 30 seconds to summarize.

MR. ALI AWAN: Okay. Well, actually, I'm pretty much done. I'm happy to take any question that you might have.

VICE CHAIRMAN MULVEY: What about the data time line with URCS data? Is that a problem at all? URCS data is not as current as you might like?

MR. ALI AWAN: Right. You usually have about a year/year and a half --

VICE CHAIRMAN MULVEY: Year and a half.

MR. ALI AWAN: -- backlog depending on how quickly the data is processed.

You can index those numbers back quite easily. So, I don't think that's going to be too much of a problem or up if you want.

VICE CHAIRMAN MULVEY: Um-hum.

MR. ALI AWAN: It can be done because those indices exist. So, it's a very simple computation.

VICE CHAIRMAN MULVEY: Yes. It does strike me that some of these things can be done with today's modern computers, and given the availability of high speed computers that the railroads have, we have here and having people like you on board, should be more doable and not quite as onerous as it's made out to be.

MR. ALI AWAN: I agree.

CHAIRMAN BUTTREY: Ms. Dearder, you may proceed.

MS. DEARDEN: I'm Sandra Dearden with Highroad Consulting and I thank you for the opportunity to present our views in this proceeding.

I filed a statement in the proceeding. I'm not going to cover all those points, but I think I would like to cover a few points and also clarify some of the disconnect that you identified, Chairman, today in what the railroads are presenting versus what the shippers are saying.

I think the railroads' point of view that they're under recovering their fuel expenses is probably accurate, but what they're doing is they're looking at the big picture and the total fuel costs where the customers, rail customers, who are paying surcharges under the standard surcharge programs are overpaying for fuel.

As Awan said, we prepared cost evidence for four clients who also filed statements into this proceeding. It's important to note that the fuel surcharges that we used in the analysis were the average fuel surcharges paid in 2005. The reason we did that is to protect the confidentiality of the clients' rates and so because the surcharges starting escalating at the back end of 2005 and are much higher in 2006, that was somewhat of a conservative approach.

We studied 25 lanes and in every case, the fuel surcharges were at least four times the total cost of fuel on the move.

In the CSX filing, I noted that they said that fuel is an integral part of their rate negotiations. We recently helped a client to determine where to build a new manufacturing facility in New York and they've announced and they're going forward. That plant will open in 2007.

So, in the negotiations, we asked why the standard fuel surcharge program would apply since the fuel costs that applied in 2001 and 2002 would not be relevant to shipments that would start occurring in 2007, but they were totally inflexible on that position.

Oh, another thing that happened with another negotiation with a client was when we started talking about addressing the fuel surcharges with that railroad. They said we have embraced the rail fuel surcharges and we need the money because we have this new theme which is re-investability and re-investability is they need the money to reinvest capital into their system because of deferred maintenance and the need to increase capacity. It seems to me that that is not what the purpose of the fuels surcharges are.

In our filing, we have a number of

recommendations and I'd just like to touch on a couple. We would like for the Board to adopt some principles on what to do about fuel surcharges and we would recommend that when needed and not for -- we hope that this can be worked out between the shippers and the carriers, but that you have a mediation process and that reparations be considered when we can prove overcharges.

Also, as Awan suggested, the fuel cost should be reported as a separated line item in the URCS data and also I'd like to request that any actions that come out of this proceeding also apply on exempt traffic.

CHAIRMAN BUTTREY: Thank you very much.

MS. DEARDEN: Yes.

CHAIRMAN BUTTREY: Yes, sir, you may proceed.

MR. BEHE: Hi. Thank you for the privilege.

My name is Mike Behe and for the past six years, our small firm, Freight Resources Network, has been serving the information needs of rail shippers.

Now, we were founded by former Conrail executives. During that six years, we have grown our customer list to where it now includes over 200 of the largest rail shippers in North America. Many of them are here today.

It is relevant to note that our customers make regular use of the information in the STB's public waybill form.

In its notice announcing this public hearing, the Board stated that in this hearing shippers and railroads are asked to comment on whether and how railroad reporting requirement should be adjusted to provide rail customers with better information on a carrier's fuel costs and maybe more importantly, the revenues collected through fuel surcharges.

The Board goes on to say making this information publicly available should enable shippers to better identify and protect against inappropriate surcharges and to more reliably forecast their future transportation costs.

Make no mistake about it, information does help rail shippers manage their transportation costs.

You've heard the shippers claim over recovery and the railroads claim under recovery. I want to quote the first speaker of the day. I'm the last speaker of the day. I'd like to quote the first speaker of the day the Honorable Brian Schweitzer, Governor of Montana, said that "The devil is in the details" and I think he's right.

In written and spoken testimony, the Board has heard that highly-rated chemical shipments pay higher surcharges than low-rated mineral shipments. Fuel surcharges on wheat run higher than corn. Movements involving railroad provided equipment pay higher surcharges that similar moves in private equipment and you've either read or heard other examples obviously.

Yet, none of these cost recovery disparities can be contributed to differences in the railroad's fuel consumption.

Consistent with the Board's request as to how you might adjust railroad reporting requirements, FRN recommends that the STB move quickly to collect detailed fuel surcharge revenue data from sample railroad freight bills and include it in the public version of the carload waybill sample.

Now, the Board has heard testimony from other witnesses today implying the need for such an initiative and over the past few months, FRN has heard similar comments from many of our customers. We, therefore, recommend that the Board require the railroads to submit their fuel surcharge revenues for each sampled freight bill and that this revenue appear in the public waybill file as a separate and distinct data field. Surcharge revenues are too significant and evidently too permanent to continue to ignore them in this sampling process.

Now, in order to protect the confidentiality of any contracted-base freight rates, we recommend that the Board adopt the following reporting requirements. In situations where the railroad applies a percentage to the actual freight weight to determine the fuel surcharge amount and where the base freight rate is in tariff or public price form, the fuel surcharge revenues would be captured and displayed exactly as they are billed.

However, if the base freight rate is a confidential contract, then obviously under the percentage arrangement revealing the surcharge would reveal the contract. The fuel surcharge revenues would be disguised using the same method applied to the corresponding base contract freight rate.

When the railroad utilizes a mileage-based method for calculating the fuel surcharge or any other method that may be devised in the future that does not involve use of the base freight rate in its derivation, the fuel surcharge revenues would be captured and displayed exactly as they appear on the freight bill.

In closing, we respectfully encourage the Board to, one, immediately begin collecting this data from the railroad. Two, include fuel surcharge revenues in a separate and distinct data field in the public waybill file and do so at the earliest possible opportunity and three, because timely data is worth a lot more than late data, take every available means to accelerate the processing of and advancing the periodic release date for the public waybill file.

Very grateful to have the opportunity to share these views with you today.

CHAIRMAN BUTTREY: We thank you very much for being here sharing that with us.

I'd like to open up the panel again if I could for not necessarily rebuttal, but an opportunity to speak to anything any other panelist said. You all seem to be sort of saying the same things, but there are some differences that I detected anyway and anybody on the panel could have a closing statement if they'd like to do that.

MR. O'CONNOR: I'd like to take that opportunity.

First, Awan, I have the greatest respect for him. He's highly skilled, but I've been thinking about the proposal that he just offered and let me be a railroad guy just for a minute and come at that from a different direction.

I will have the data that you didn't require me to report, but I have it. You don't have it. Awan doesn't have it because I didn't report it and if you follow this action plan or Jay's plan, you will have more data to work with. Both sides will eliminate the problem of lack of a transparency.

Okay. So, I'll have more data than you will have as we walk into the negotiations. We'll both know URCS, but I will know more about it than you do. I will know, for example, that the factors that drive the URCS' unit costs are not only the regression results. There are factors imbedded in URCS that go all the way back to rail form A. Equated switch factors is the primarily incidence. It goes back to the 1940s.

So, you're coming at me with URCS. I'm coming after you with the actual knowledge of whether over recovered.

Cut to the rail TOFC. It's the largest growth area for rail right now and it's a problem for rail because the profit margins are weak in rail TOFC and the volume is growing and they're going to be pressing hard on this.

The factors is in URCS that deal with rail TOFC go back to the 1970s. Way before double stack.

Double stack came on during my watch at the AAR. I was AVP of Economics and I got a call one afternoon from a shipping line. I won't say the name, but their initials are APL and they began asking questions about TOFC and later that week, I got a call from a railroad and I won't say their name, but their initials are UP. Same kind of questions and basically, the upshot of that was APL came to UP and said we have a new idea and UP said well, it might work. Might not. We'll sell you the whole frame. Good luck. And it worked.

That meant that the factors that described the 1970s would not describe the 1990s.

So, there's a role for micro in this, but you must have the macro data to compute that simple piece of information that we've spent the day debating. Did we over recover or under recover? They know. You don't. I'd like to know.

CHAIRMAN BUTTREY: Anyone else?

MR. ROMAN: I thought I'd also just add a few words and that is what I'm amazed at with this fuel surcharge is that this isn't rocket science. This is pretty much bean counting. Numbers that we go through in our fuel surcharge study, this is bean counting and all we're really looking for is to eliminate some of the uncertainty in the numbers.

Railroads submit an awful lot of data to the STB and from my perspective, you got to know where you are before you know where you can get to and there's been a lot of numbers presented here today and a lot of them with incremental cost increases from the base time frame. Need to be focusing on what's the total fuel cost and what's the total revenue that they're collecting from you because you got to know where you are before you know where you can get to and by just changing a little bit more of reporting to the railroads, I think it can be simplified.

I think it can be streamlined and the biggest thing is for both the Board and the shipping community to have the beans available to count so that we don't have to be sitting in a room like this all day and listening to two dramatically different stories. We all have to be working from the same page.

And anything that can come out of this

hearing that will do that will make this even though it's a very long day, will make it a very constructive day.

VICE CHAIRMAN MULVEY: You know, it's bean counting that on its face it would seem to be something that you could do fairly quickly, but I remind you that the highest IQs are not astrophysicists or medical doctors, but CPAs and there's probably a reason for that. It can sometimes be very, very difficult to tease out the data.

What would seem to be a fairly simple calculation, as you've seen today often is not. We have the railroads doing their calculations and saying here's what it is. We're undercollecting. And the shippers doing their shippers' calculations and having them vary quite a bit, too. Even if those have not been consistent, they all consistently said the railroads are under collecting.

Clearly, we do need the data, but clearly we need to get the data in a format where we can do our own calculation and decide what, in fact, it is costing and what, in fact, is being charged.

My guess is it's the second piece of that that might be more difficult to tease out.

MR. ROMAN: Well, there are also some other -- you've heard things a lot of different ways in here. The issue of hedging and where the benefit and loss from hedging goes. I mean there are some decisions that need to be made from the Board's side of it, but you still need all the information even to make an educated decision on some of those things and anything we do to further that is going to tell us a lot about where we are now and probably give us a pretty good road map of where we need to get to.

VICE CHAIRMAN MULVEY: Hedging is certainly a complicating factor. We've had some of the shippers say that hedging shouldn't be on the table. That that's a risk that the railroads take and therefore, even though if they are paying that for the fuel, that's a risk that they took and we'll just take the hedging activity off the table in doing the calculations.

Others have said no, hedging is an important consideration and we should include it. So, it goes both ways. You're right.

MR. AWAN: I would add with all due respect to Tom that using URCS and providing that information to shippers would lessen the asymmetry problem that is really the crux of the matter here and as a threshold matter, you know, if you can show that your fuel surcharge is in excess of the total fuel cost associated with that movement, then you've made a very strong showing that the fuel surcharge is unreasonable and if you can show that the fuel surcharge is greater than the delta between what the fuel cost was and basically the change in fuel cost, then you've had a weak showing that the fuel surcharge may be in excess of what a proper fuel surcharge might be.

So, as a threshold matter, I think it really empowers the shipping community to go out there and find out hey, is this a realistic shipping fuel surcharge or not and now, should we move forward on it and from that point forward, I think I would defer to Tom that more data might be required to make a more exact assessment of where you really are.

CHAIRMAN BUTTREY: We are coming up on the end time for these rebuttals.

MR. O'CONNOR: I agree with my friend Awan and we submitted a couple of figures that show exactly Awan's point. It shows that the percent variance from the average fuel surcharge depending on the commodity can be 200, 300, 400, 500 percent which establishes the point that you're driving to.

That pertains by the way whether we're looking at average fuel surcharge for commodities, we selected Houston to LA to Vegas. We also looked at Chicago to the New Jersey region. One on the east. One on the west. And looked at a variety of commodities.

Although we were working at the request of the American Chemistry Council, we found that they particularly disadvantaged. We found that nobody was helped by this current method. Nobody.

VICE CHAIRMAN MULVEY: Thank you very much. We have finished.

CHAIRMAN BUTTREY: Well, since Mr. Strege's still in the room, I'll commit to him that we're going to separate the wheat from the chafe.

Thank you very much. This hearing is concluded.

(Whereupon, the hearing was concluded at 5:44 p.m.)