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June 18, 2004

By Hand Delivery

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001



Re: STB Docket No. 42072, Carolina Power & Light Company v. Norfolk Southern Railway Company

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are a signed original and sixteen (16) copies of the Defendant Norfolk Southern Railway Company's Reply to Carolina Power & Light Company's Statement of Position Regarding Fuel Surcharge Reparations.

Please acknowledge receipt of this submission for filing by date-stamping the enclosed duplicate paper copy and returning it to our messenger. If you have any questions concerning this filing, please contact the undersigned. Thank you for your attention to this matter.

Very truly yours,

G. Paul Moates
Paul A. Hemmersbaugh
Donald H. Smith

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Enclosures

cc: Counsel for Complainant (w/encls.)

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

CAROLINA POWER & LIGHT COMPANY,

Complainant,

v.

NORFOLK SOUTHERN RAILWAY COMPANY,

Defendant.

STB Docket No. 42072



**DEFENDANT NORFOLK SOUTHERN RAILWAY COMPANY'S
REPLY TO CAROLINA POWER & LIGHT COMPANY'S STATEMENT OF
POSITION REGARDING FUEL SURCHARGE REPARATIONS**

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DATED: June 18, 2004

INTRODUCTION

Pursuant to 49 C.F.R. § 1104.13, Defendant Norfolk Southern Railway Company ("NS") respectfully submits this Reply to Carolina Power & Light Company's Statement of Position Regarding Fuel Surcharge Reparations ("CP&L Statement") filed on June 4, 2004.

The CP&L Statement fails to address the simple fact that NS' actual fuel costs have increased dramatically since the record was closed in this proceeding, and are now at least 25 percent higher than the \$0.66 per gallon figure incorporated in the Board's recent decision (served December 23, 2003) ("Decision"). Attempting to ignore this reality, CP&L asserts that "[f]uel-related dollars are accounted for by the Board's decision," which "already considers and already reflects those cost changes." CP&L Statement at 7, 9. These assertions are incorrect. The rates prescribed in the Board's Decision reflect the small, steady cost increases incorporated in the RCAF-U. The prescribed rates do *not* reflect recent spikes in the market price of diesel fuel and in NS' actual fuel costs, as shown in its most recent financial reports.¹

NS established its fuel surcharge rule as part of its standard Conditions of Carriage, governing all NS common carrier movements, long before CP&L filed its Complaint in this case. CP&L clearly had notice of the terms of NS' Conditions of Carriage, including the fuel surcharge rule. Yet CP&L did not address the fuel surcharge in its Complaint or in any of the three rounds of evidence submitted in this proceeding, and did not mention its existence until after the Board issued its Decision (far too late to raise new issues). Although CP&L now contends that the scope of its Complaint was intended to include the fuel surcharge rule (*see* CP&L Statement at 9), the plain language of the Complaint does not support that claim. In any

¹ *See* NS Quarterly Financial Review - First Quarter 2004, at 18-19, attached as Exhibit D to Defendant Norfolk Southern Railway Company's Statement of Position Regarding Fuel Surcharges (filed June 4, 2004) ("NS Statement").

event, CP&L abandoned any such contention when it failed to submit any evidence whatsoever addressing the fuel surcharge issue.

Accordingly, NS' fuel surcharge rule should be deemed to be valid, effective, and applicable to the rates prescribed in the Decision.

I. CP&L'S COMPLAINT AND EVIDENCE DID NOT CHALLENGE THE NS FUEL SURCHARGE RULE.

CP&L's Complaint and evidence challenged only the line-haul rates established by NS at CP&L's request. *See, e.g.*, NS Statement at 4-7; Complaint ¶ 14 (describing the "common carrier rates assailed in this Complaint"). CP&L's Complaint did not mention the fuel surcharge rule at issue, nor did it otherwise challenge NS' Conditions of Carriage or any other classification, rule or practice established by NS.

Despite its prior silence on this issue, CP&L now asserts that it *intended* to include the fuel surcharge rule within the scope of this proceeding. In particular, CP&L contends that the language of its Complaint should be interpreted to include any changes in the challenged rates, including any additional charges resulting from the application of the fuel surcharge rule. *See* CP&L Statement at 9 ("[i]t was the total level of NS's coal transportation charges -- as reflected in the entirety of NS's January 29, 2002 rate offering and as subsequently 'change[d] or adjust[ed]' -- that CPL challenged in its Complaint"), *citing* Complaint at 5, 8. But the portions of the Complaint cited by CP&L do not support this interpretation.

The first cited portion of the Complaint ("at 5") does not mention any rate changes or adjustments at all, and has no conceivable connection to the fuel surcharge rule. The second cited portion (at 8) includes a reference to "any changes or adjustments [in the challenged rates or terms] that may be established by NS during the course of this proceeding ... in response to

CP&L's request" for a rate quotation.² Of course, the fuel surcharge rule was *not* established "during the course of this proceeding," and it was *not* established "in response to CP&L's request." Rather, as described above (and in NS' Statement at 3-4), the fuel surcharge rule is a system-wide cost recovery mechanism, applied to all common carrier movements, which was established long before the events leading to this proceeding.³ Thus, the cited portions of CP&L's Complaint cannot reasonably be interpreted as referring to the fuel surcharge rule or to NS' Conditions of Carriage.

CP&L clearly was on notice as to the existence of NS' Conditions of Carriage, including the fuel surcharge rule, both before it filed its Complaint, and during the pendency of this proceeding. This fact is underscored by CP&L's payment of the surcharge amounts throughout this case.⁴ If CP&L had intended to refer to the fuel surcharge rule in its Complaint, or to include it within the scope of this proceeding, CP&L undoubtedly would have sought discovery and submitted evidence and argument addressing the issue. CP&L's failure to do so demonstrates that it never intended to challenge the reasonableness of the fuel surcharge rule (at least until the Board issued its Decision).

² The relevant paragraph (§ 15) in its entirety reads as follows (emphasis added):

This Verified Complaint covers any changes or adjustments in any of the assailed common carrier rates or charges, or changes in any service or other terms, that may be *established by NS during the course of this proceeding* (including new or replacement rates, charges or other terms) for railroad transportation services *in response to CP&L's request* as described in Paragraph 7 of this Verified Complaint.

³ NS' Conditions of Carriage were expressly incorporated in its rate quotation to CP&L. *See* NS Statement Exhibit A, at 2. The only change in the terms of the fuel surcharge rule occurred on March 1, 2004, several months *after* the Board's Decision, when NS modified its calculation of the fuel surcharge to more closely reflect fuel price fluctuations and to provide more lead time for customers to react to changing fuel costs. *See* NS Statement Exhibit C.

⁴ CP&L stopped paying the assessed surcharge only *after* the Board issued its December 23, 2003 Decision herein.

In any event, CP&L abandoned any possible claim relating to the fuel surcharge rule by failing to submit any evidence whatsoever relating to its lawfulness or reasonableness, or to any of the other terms of NS' Conditions of Carriage. CP&L's failure to pursue this issue amounts to a default and a complete failure of proof, and NS is entitled to judgment on this issue for that reason alone. At this stage of the proceeding -- more than *one year* after the close of the evidentiary phase, and long after the Board has issued a decision on the merits -- it is far too late to permit CP&L to raise entirely new issues (or to revive issues that it could have raised in its Complaint) regarding NS' fuel surcharge rule or its Conditions of Carriage.

A classification, rule or practice that is not challenged by a shipper in its complaint and evidence is presumptively valid, and must be applied in accordance with its terms. *See* NS Statement at 5-7. Because CP&L did not effectively challenge NS' fuel surcharge rule in its Complaint and evidence, and because it is far too late for CP&L to raise any such issue now, the surcharge rule should be presumed to be valid and effective, like the other standard classifications, rules, and practices published in NS rules tariffs and other governing publications.

II. THE FUEL COSTS INCORPORATED IN THE BOARD'S DECISION DO NOT REFLECT RECENT FUEL PRICE INCREASES.

CP&L also contends that NS' fuel surcharge rule should not be applied to the rates prescribed in the Board's decision because the Board's "multi-year prescription approach already considers and already reflects [the] cost changes" which have triggered the fuel surcharge rule. This assertion simply fails to acknowledge the reality that diesel fuel prices have increased sharply and unexpectedly since the close of the evidentiary record in this case. Contrary to CP&L's assertion, neither the parties' evidentiary submissions nor the Board's Decision anticipated or accounted for these sharp price increases.

The Board's Decision adopted CP&L's fuel cost evidence, based on the NS system average fuel cost for the year 2001, indexed to 2002, yielding a cost per gallon of \$0.6574, adjusted for subsequent years using the RCAF-U index. Decision at 27-28, 57; *see* NS Statement at 8-9. But the RCAF-U index has increased only slightly since then, producing an implied fuel cost increase of less than two cents per gallon. *See* NS Statement at 8. In fact, NS' actual fuel costs have increased sharply during the same time period, averaging \$0.807 during 2003 and \$0.831 during the first quarter of 2004. *See* NS' Quarterly Financial Review - First Quarter 2004, at 18-19 (NS Statement Exhibit D). NS' actual fuel cost data for the first quarter of 2004 reflect an increase of more than 25 percent over the cost applied in the Board's decision, served less than six months ago.

Despite the fact that the RCAF-U index does not reflect short-term swings in the cost of diesel fuel, CP&L asserts that the application of NS' fuel surcharge rule to the rates at issue is unnecessary, because the Board's approach to rate prescriptions "more than adequately insulates NS from the impact of cost increases." CP&L Statement at 8. CP&L offers three related arguments in support of this assertion, each of which is meritless.

First, CP&L argues that the Board's SAC analysis is based on an NS common carrier rate "which itself reflects GDP/IPD-based increases" over the course of the 20-year SAC analysis. CP&L Statement at 8. But the fact that the NS rate applied in the SAC analysis was designed to reflect inflation-based increases gradually over a 20-year period does not "adequately insulate" NS from drastic short-term fuel price increases such as those NS -- and other railroads, air carriers and motor carriers -- has experienced since 2001. Moreover, the gradual rate increases produced by GDP/IPD-based escalation simply reflect expected increases in costs. Without these inflation-based increases, the constant-dollar value of the rates at issue would be eroded,

and would actually *decrease* in real terms over time. Thus, the application of GDP/IPD-based increases to the base rates at issue does not provide an extra “cushion” to insulate NS from unexpected fuel price *increases*.

Second, CP&L argues that the application of the RCAF-U further “insulates” NS from short-term fuel price shocks. As described above, however, the application of the RCAF-U has been patently inadequate to offset the drastic fuel cost increases actually incurred by NS since the close of the evidentiary record.

Third, CP&L argues that the parties’ annual recalculation of the jurisdictional threshold will further insulate NS from fuel cost increases, even if those cost increases have the effect of driving NS’ revenue-variable cost ratios for the issue traffic down to the jurisdictional threshold of 180 percent. CP&L asserts that the jurisdictional threshold will guarantee that NS will be entitled to charge rates that allow it, at minimum, to recover all of its costs and a “generous profit.” CP&L Statement at 11. Notwithstanding this fanciful rhetoric, the only “guarantee” that CP&L means to offer is the fact that “NS will never be obligated to provide service at rates less than 180 percent of its variable costs.” *Id.* at 8.

CP&L frankly acknowledges that “the current SAC rate” (*i.e.*, the rate that the Board has prescribed as reasonable under the Coal Rate Guidelines) “vastly exceeds the Board’s jurisdictional threshold in the instant case.” *Id.* at 8. In other words, the rate that the Board has prescribed as reasonable in this case generates R/VC ratios that are well above 180 percent.⁵

CP&L knows that under its proposed approach, NS could be forced to absorb enormous fuel cost

⁵ The Board’s accepted CMP principles require that NS seek to recover a greater share of its fixed and common costs from highly demand-inelastic shippers such as CP&L. If NS were allowed to recover only 180 percent of its variable costs – well below NS’ RSAM – from shippers such as CP&L, NS would be unable to recover its total costs, and the concept of differential pricing embodied in the Board’s CMP would be undermined.

increases before the jurisdictional threshold could provide any meaningful limit. Nonetheless, CP&L argues that the Board should adopt a policy that will force it to ignore these real-world cost increases, and over time, could force NS to charge rates that are no higher than the jurisdictional threshold level – effectively undermining the Board’s rate reasonableness findings. This argument represents a collateral attack on the Board’s Decision and on its rate reasonableness jurisdiction. The Board should reject this collateral attack, and should decline CP&L’s invitation to ignore the real-world cost increases that NS and other rail carriers must confront when their fuel costs suddenly rise.

CP&L also asserts that NS’ fuel price hedging program allows it to keep its fuel costs “stable or even to reduce those costs.” CP&L Statement at 11 n.4. Unfortunately, that assertion is overly optimistic. Although NS’ fuel hedging program has helped to lessen the impact of rapid increases in diesel fuel prices in recent years, it has not fully offset higher fuel prices. *See* NS Open at 8-9 and n.7. To the contrary, NS’ *actual* diesel fuel costs (which include the effects of the fuel hedging program) have increased by more than 25 percent from the 2001 fuel cost figure applied in the Board’s Decision.⁶

III. STANDARD FUEL SURCHARGES MAY BE APPLIED TO PRESCRIBED RATES.

Although CP&L cites a few early ICC cases stating that a carrier has no right to charge a rate that has been held to be unreasonable,⁷ none of the cases cited by CP&L address the question at issue here, which is whether NS can apply a fuel surcharge rule (or other rule,

⁶ NS does not hedge all of its fuel needs, and must pay spot market prices for the portion of its diesel fuel which is not hedged. Moreover, when fuel prices decline, NS’ hedged fuel costs tend to be higher than the then-current spot market price. In addition, NS incurs certain transaction costs in administering its hedging program. Thus, while NS’ fuel hedging program helps to reduce the impact of diesel fuel price volatility in the short run, it does not guarantee that NS will pay lower total fuel costs in the long run. NS Open at 8-9 and n.7

⁷ *See* CP&L Open at 9, *citing Commercial Club of Omaha v. Anderson and Saline River Ry.*, 19

classification or practice) to a prescribed rate, when the rule at issue was never specifically challenged, and has never been held to be unreasonable.

Lacking any authority to support its position, CP&L simply asserts that NS' "compound" rate structure (meaning the combination of its line haul rates plus the fuel surcharge rule) would "undermine the efficacy of the Board's prescription of maximum rates." CP&L Open at 10. This argument, however, overlooks the fact that most rail rates traditionally have been published in similar form, consisting of basic line-haul rates that are subject to a variety of additional rates and charges. Most major rail carriers have established fuel surcharge rules, yet CP&L has not cited any cases in which the application of a fuel surcharge rule to a prescribed rate was held to be unreasonable. The existence of these fuel surcharge rules has not undermined the Board's ability to prescribe maximum reasonable rates, or the efficacy of such prescribed rates.

In order to preserve traditional common carrier rate practices, the Board should uphold the fundamental principle that a rail carrier "may establish any rate for transportation or other service," 49 U.S.C. § 10701(c), and that such a rate will be presumed to be valid and effective unless and until it is challenged and shown to be unreasonable. 49 U.S.C. §§ 10704(b), 11701(a) (Board may consider the reasonableness of a rail carrier's rate, classification, rule, or practice "only on complaint"). Because CP&L's Complaint and evidence in this proceeding failed to address (or even mention) the fuel surcharge rule, the Board should decline CP&L's request at this late date that the rule be found to be unreasonable.

CPL asserts that if NS is allowed to apply the fuel surcharge rule to the prescribed rates, it might also attempt to establish "other cost-related surcharges upon the CP&L traffic at levels that exceed the rates prescribed by the Board." CP&L Open at 10. But such hypothetical

I.C.C. 419, 421 (1910) ("if the rate was unreasonable, the carriers had no right to charge it...").

scenarios are not at issue in this case. Although it is conceivable that a rail carrier could attempt to circumvent a rate prescription by establishing wholly new charges for the transportation at issue after a decision has been issued, the Board has ample authority to deal with such tactics.

In this case, however, the NS fuel surcharge rule was already in effect long before CP&L's Complaint was filed. CP&L can hardly claim that NS engaged in any kind of unfair tactics in establishing the fuel surcharge rule. To the contrary, CP&L was aware of the fuel surcharge rule, and paid the applicable fuel surcharges during the pendency of this proceeding, but failed to challenge the rule in its Complaint and evidence, and failed to raise any issue regarding the surcharge until after the Board issued its Decision.

The course of this proceeding also demonstrates why it is appropriate, and indeed necessary, to permit rail carriers to apply previously-established fuel surcharges (and similar rules, classifications and practices) to prescribed rates, without undertaking the time-consuming and burdensome procedure of requesting reopening and submitting new evidence. By the time the parties have completed the submission of new evidence, and the Board has rendered its decision, it is quite likely that the relevant fuel costs will have changed again, either by returning to the norm or by reaching a new level that would require further updates to the record. The application of a standard fuel surcharge rule allows rail carriers to adjust their rates expeditiously, in accordance with changes in fuel costs, and to remove such fuel surcharges as soon as fuel costs subside. The Board should allow the application of such standard fuel surcharge rules to line-haul rates, including prescribed rates, unless and until such surcharges are properly challenged and shown to be unreasonable in accordance with the governing statute and the Board's established precedents.

Respectfully submitted,



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Counsel for Defendant Norfolk Southern Railway Company

DATED: June 18, 2004

CERTIFICATE OF SERVICE

I hereby certify that, on this 18th day of June, 2004, I served the foregoing
“Defendant Norfolk Southern Railway Company’s Reply to Carolina Power & Light Company’s
Statement of Position Regarding Fuel Surcharge Reparations” by causing five (5) copies thereof
to be delivered, via hand delivery, to:

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