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April 27, 2006

VIA HAND DELIVERY

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, N.W., 7th Floor
Washington, DC 20423-0001

ENTERED
Office of the Secretary

APR 27 2006



Re: STB Ex Parte No. 661 – Rail Fuel Surcharges

Dear Mr. Williams:

In accordance with the Board's Decision issued March 14, 2006, in the above-referenced proceeding, enclosed is the Testimony of TOTAL PETROCHEMICALS USA, INC.

Respectfully submitted,

Michael F. McBride

Michael F. McBride

Attorney for

TOTAL PETROCHEMICALS USA, INC.

Enclosure

TOTAL PETROCHEMICALS

W. Alan Cramer
Manager – Supply Chain Logistics
Telephone: 713-483-5310
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April 27, 2006

By Electronic Filing

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

Office of Public Hearing

Public Hearing

Re: Written Testimony for Ex Parte No. 661 – RAIL FUEL SURCHARGES

Dear Mr. Williams:

Enclosed is TOTAL PETROCHEMICALS USA, INC.'s Written Testimony for presentation at the Board's May 11, 2006 public hearing in the above referenced matter.

Very truly yours,

W. Alan Cramer

Enclosure



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BEFORE THE SURFACE TRANSPORTATION BOARD

EX PARTE NO. 661

HEARING ON THE RAIL FUEL SURCHARGES

SUBMISSION OF WRITTEN TESTIMONY

STEPHEN J. POCSIK – VICE PRESIDENT SUPPLY CHAIN

AND

ALAN CRAMER – MANAGER SUPPLY CHAIN LOGISTICS

TOTAL PETROCHEMICALS USA, INC.

TOTAL PETROCHEMICALS USA, INC. ("TPI") appreciates the opportunity to submit written testimony to the Surface Transportation Board ("STB") about the impact of the rail industry's fuel surcharge practices on TPI.

I would like to re-introduce you to TPI. TPI is a producer of petrochemicals (polypropylene, polyethylene, styrene, polystyrene), base chemicals and transportation fuels with production facilities in Texas and Louisiana. TPI has built its petrochemicals business with a strong manufacturing emphasis, based on world-scale plants and technologically advanced operations. TPI manufactures petrochemicals for the plastics industry. We produce plastic pellets, which are used in the manufacture of everyday household items like food containers, furniture, carpets, and beverage bottles to name just a few.

Through the years, we have cut every operating dollar possible out of our manufacturing budgets yet our costs to distribute continue to grow at alarming rates year after year. We ship our products from our petrochemical plants primarily by rail. In fact almost 100% of our production leaves our plants via railcar. As a rail shipper, we have been subjected to excessive rail transportation charges that now include questionable fuel surcharges. All of that for service levels that continue to deteriorate on an almost daily basis. In fact, the Industry is certainly one of the few American industries where a customer is continually required to pay more for less service or product value. The



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railroads say in unison "ship it our way or don't ship at all". Their service, their pricing policies, their commercial practices and to this point their fuel surcharge programs prove that they are an "oligopoly" or at least a series of monopolies. Now is the time for TPI and other shippers like us to receive relief.

One could say our testimony relates this hearing on fuel surcharges to the age-old question, "Which is heavier a ton of bricks or a ton of feathers?" Logic, of course, says that they are equal, each weighing one ton, however when looked at in terms of the rail industry's fuel surcharge programs, logic does not prevail. The rail industry would rather ask: "Which one is captive, the feathers or the bricks?" "Upon which one can we impose a higher rate?" So shippers ask these questions about the current rail fuel surcharge programs: "Railroad fuel surcharges, just what are they?" "Are they cost protection or a new profit center?" "Why are they rate-based and not consumption-based? What happens to fuel efficiency gains?" "Why do shorter-line hauls have larger surcharges than longer-line hauls, even on the same railroad?" "Why were surcharges collected at the same time hedging strategies were successful?" "Why aren't fuel-efficient routes charged lower surcharges than those routes that are inefficient?" Until recently, we also asked, "Does anyone in the government care?" With this proceeding we are hopeful that the answer to that question is "yes."

The shipping community asks: "Why do some Class I railroads (i.e., the BNSF) agree that significant disparities exist between surcharges assessed and actual incremental fuel cost increases?" "Are fuel surcharges accurately reimbursing the rail industry for the increased cost of fuel?" "Or are fuel surcharges overcompensating the railroads for their added fuel expenses and actually providing an additional profit center?"

Surcharges are not new. They are generally designed to allow a supplier to recover unanticipated market increases in a consumable material that were not taken into account when the service/product was originally contracted. Fuel surcharges, at most, should only be a mechanism to recover unforeseen fuel costs. Even then, they should not be imposed if a contract explicitly excludes the possibility for a surcharge. (Imagine what the reaction would be if, instead of fuel surcharges, the price of oil had fallen through the floor, as in 1985-86, and shippers were arguing that the railroads should give them a credit rather than pay a surcharge where the shipper had agreed to a contractual formula that did not take the drop in fuel prices into account. The railroads would argue, with good reason, that such a position was unreasonable. So, therefore, is it unreasonable for railroads to seek fuel surcharges when contracts preclude them or provide a different mechanism, such as the Rail Cost Adjustment Factor published by the STB, to adjust rates.)

It is clear that the fuel surcharge methodologies imposed by the Class I railroads go beyond cost recovery, especially when applied to individual movements. In fact, these methodologies have led to a new source of profit enhancement for the rail industry. In



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January 2005, the rail industry analyst for Citigroup Smith Barney reported that as much as 20-30% of one Class I railroad's Earnings Per Share (EPS) growth in 2004 was attributable to "fuel surcharge revenue above fuel expense increases." TPI agrees with the findings of the National Industrial Transportation League (NITL) in its fuel surcharge "white paper" that the rail industry has ample opportunities to adjust freight rates and to take into consideration fuel costs, as TPI knows under in its own circumstances. We also agree with NITL that the calculation methods, formulas and billings of the current fuel surcharge programs were likely generated expeditiously and for simplicity. However, fuel surcharges should never become a profit-enhancing mechanism. At the same time that surcharge programs were being implemented, some of the Class I railroads were also using fuel-hedging strategies. When added to the surcharge program, the hedging successes provided an even greater EPS growth factor.

"Microsofting" is defined as a "back door market manipulation in an effort to establish a monopoly through a dictated-by-design influence established by one person, entity or in this case industry." Since the Staggers Rail Act of 1980, shippers have seen the "Microsofting" of the railroads. This "Microsofting" phenomenon has been to the shippers' detriment in terms of cost and service, as well as shippers' abilities to negotiate rates and commercial terms with the rail carriers.

Today, rail carriers can and do act capriciously and without regard to the actual terms of their contracts and to the spirit and intent of the contract negotiations. This includes their fuel surcharge programs. Shippers cannot go to the STB for any relief or remedy from such commercial conduct if they have a contract. Shippers must expend extraordinary internal resources and time—measured in years in some instances—just to get a contract. Then they must spend additional time and internal resources to fight and correct these charges that are imposed where the contract explicitly excludes them. TPI has experienced a Class I railroad unilaterally canceling storage agreements and imposing accessorial tariff charges (fuel surcharges), despite express contractual language that was negotiated with the rail carrier so as not to allow a fuel surcharge.

Key messages from TOTAL PETROCHEMICALS USA, INC.:

1. **The Railroad pricing model is monopolistic, illogical and unfair.** For example our plant in LaPorte, TX is able to be accessed by more than one rail carrier, and is 1,267 transit miles from Chicago IL. On the other hand our Carville, LA plant (Bruns) is captive because only one rail carrier has access to it. This plant is 935 transit miles from Chicago. Our rates to Chicago on the captive route are 225% higher than those on the competitive route even though it is a shorter route. In other words if our rate from LaPorte to Chicago is approximately \$1,500, our Carville rate will be \$3,375 for transporting non-hazardous cargos of plastic pellets. (We have used a hypothetical to mask the actual, highly confidential



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contract rate.) The only difference is that our Carville facility has no choice in rail carriers.

2. **Railroad fuel surcharges are profit centers not surcharges.** The rail industry is now unified in demanding fuel surcharges even on contracts that do not include or explicitly prohibit a fuel surcharge provision. While we understand the concept of a surcharge, we do not accept that all surcharges are absolutely necessary and we certainly do not accept the current rate-based methodology. No provision for fuel economies of newer more fuel efficient equipment is considered, no adjustment for higher- or lower-use routes is made. Therefore, the current method of calculating fuel surcharge is not a surcharge to offset the rapid rise in fuel costs. It is simply an additional profit center. If it were not so intended, the design would be based on consumption. This rate-based method simply imposes a percentage charge on each freight rate. Using the example in #1 above, and assuming a theoretical surcharge of 15%, we would pay \$281 more in fuel surcharge costs to go the shorter 935-mile trip.
3. **Foreign competitors have a clear advantage over domestic producers.** The U.S. petrochemical Industry is struggling to compete with foreign manufacturers partially because U.S. plants are at fixed locations but foreign producers can choose their port of entry into the United States based on areas with competitive rail service. This provides our foreign competition an advantage of strategically avoiding areas where railroads engage in monopolistic pricing practices.
4. **American petrochemical jobs are at risk!** TPI, like so many others, has a global approach to corporate investment. Future growth and expansion is at stake in this issue. Corporations may decide it is much more practical to build or expand where they have rail choice or in foreign countries.

Although this testimony is not directly about railroad-pricing policies it is indirectly related to them due to the rail Industry's practice of using commercial rate structures as the basis for surcharge calculations. These calculations have never considered the true base cost of fuel already imbedded in the rail rate structure, they are based on irrelevant indices not the actual cost basis of railroad fuel, and they do not consider even basic consumption differences such as length of haul or fuel-efficient routes vs. less efficient routes. Certainly, in the current atmosphere of fierce global competition, continuing the status quo of high rail freight rates coupled with fuel surcharges which, are not tied to fuel consumption, added onto those rates will result in the continued exportation of American jobs overseas.

We believe that both balanced commercial relationships and financially strong railroads are necessary to provide the secure, effective transportation system the nation needs to



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remain competitive in the global marketplace. Balanced commercial relationships do not exist when one side is allowed to price as an oligopoly or at least as a series of monopolies. There must be a way for the railroads to achieve long-term financial viability while providing efficient service at prices that will allow American business to compete successfully in the global market. This model must include the creation of a consumption-based fuel surcharge industry wide, not a usurious rate-based surcharge which generates additional profits and which, by all accounts, has added to the rail industry's record EPS (Earnings Per Share) growth. As previously stated, a surcharge calculation should be designed to offset volatility in the cost of a consumable material. In addition, the calculation method should be logical and relate to the consumption of that material. This is a view shared by much of the shipping community, including organizations such as NITL, an organization in which the rail industry actively participates. Our statement today is designed to express the frustration of many shippers over the current rail industry fuel surcharges. There is a reason the rail industry refers to companies who use the rail network as "shippers" not "customers."

TPI believes that the STB has authority over unreasonable rates and practices. In explanation of that position TPI asserts the following four points:

1. In practice, the rail industry charges a base rate, with periodic escalators. Surcharges are then added on top of those same base rates. Under this methodology, by the railroads' own admission, fuel surcharges are not the "rates" that are being charged. (If a "rate" is challenged, a shipper must pay a filing fee, prove market dominance and prove that the rate is unreasonably high under complex rate standards. None of that is required for challenges to "rules" or "practices".)
2. Therefore, the STB has the authority to regulate surcharges (or any other "charge" a Railroad may impose on top of "rates") as an unreasonable "practice," without having to prove market dominance and proceed with a full-blown "rate" case (as noted above, a requirement if a "rate" challenge is involved) because such charges are not "rates" by definition.
3. Even if such surcharges are deemed to be "rates," STB can regulate without all that is required in a challenge to a "rate" as outlined above. Reference is made to the Union Pacific RR v. ICC 867 F.2d 646 (D.C. Cir. 1989) in STB's Notice. That case is not a bar to doing so. That case was a classic challenge to rail rates as unreasonably high, and market dominance was alleged. The ICC decided the case without a finding of market dominance. The Court of Appeals struck down the ICC's action because it regulated the rates being charged without a finding of market dominance. Moreover, when that case was decided, the statute (49 U.S.C. 10707a(h)) forbade the STB from using its rate jurisdiction to regulate railroad "rules" or "practices." However, that statute was repealed in ICC Termination Act of 1995.



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