

**BEFORE THE
SURFACE TRANSPORTATION BOARD
Washington, DC 20423**

In the Matter of:)

RAIL FUEL SURCHARGES)

STB Ex Parte No. 661

**COMMENTS OF
ARKANSAS ELECTRIC COOPERATIVE CORPORATION**

Arkansas Electric Cooperative Corporation ("AECC") respectfully submits its comments to the Surface Transportation Board in response to the Notice issued by the Surface Transportation Board (Board) inviting public comments on the manner in which fuel surcharges are calculated and charged by railroads and urges the Board to adopt rules and policies governing the use of fuel surcharges.

I. STATEMENT OF INTEREST

AECC is a membership-based generation and transmission cooperative that provides wholesale electric power to electric cooperatives, which in turn serves approximately 400,000 customers located in each of the 75 counties in Arkansas. In order to serve its member distribution cooperatives, AECC has entered into arrangements with other utilities within the state to share generation and transmission facilities. The largest of AECC's generation assets are its ownership interests in the White Bluff and Independence coal-fired generation plants, each of which typically burns in excess of 6 million tons of Powder River Basin (PRB) coal annually. AECC has a 35 percent interest in each of these plants. Entergy is the majority owner and also the operator of these plants.

II. COMMENTS

As an electric utility, AECC not only is quite familiar with fuel surcharges—as that term commonly is employed and understood, but also appreciates that fuel surcharges are appropriate and necessary when fuel prices fluctuate significantly beyond the control of the supplier.¹ Similarly, management and other employees of AECC, as consumers, are subject to fuel adjustment mechanisms as consumers of electric and gas utility services at our homes. Consequently, AECC accepts that a fuel adjustment mechanism of some type is appropriate for railroad transportation services as a general proposition.

AECC's primary concern—which we understand is shared by numerous other parties—is that railroads impose fuel surcharges not simply to recover their unanticipated and uncontrollable increases in the cost of fuel, but rather in excess of their increased fuel costs in such a manner as to enhance their net revenues.

Fuel surcharges first appeared in 2000, disappeared in 2001, and reappeared in 2002. As first instituted, railroad fuel surcharge programs were relatively small, generally amounting to 2 % of freight charges. Since reappearing, as time has passed and the cost of fuel has continued to escalate, fuel surcharges have grown substantially. Currently, fuel surcharges for coal moving from the Powder River Basin ("PRB") on Union Pacific ("UP") will increase from 17.0% in April, 2006 to 18.5% in May, 2006. UP's fuel surcharge on coal is 5% higher than its fuel surcharge on carload traffic.

¹ AECC recognizes that the Board does not have jurisdiction over contracts. Nonetheless, contracts are relevant to this inquiry inasmuch as many contracts incorporate the fuel surcharges published in the carriers' tariffs, and contract movements are a significant part of the economic picture of how fuel surcharges are used and whether they are based on the increased cost of fuel. Moreover, both western carriers have announced their intentions to move from contract to tariff pricing of PRB coal as contracts expire.

On BNSF, since January 1, 2006, fuel surcharges for coal have been applied on a mileage basis. For movement from the PRB to the White Bluff plant, the surcharge varies according to the location of the origin mine, and is on the order of \$300 per car. As market events occurring during the preparation of these comments suggest, it is expected that the railroads' fuel surcharges will continue to climb.

Unlike fuel surcharges imposed by electric utilities which are designed to recover unexpected and uncontrollable increases in the cost of fuel and therefore are based on the fuel costs as experienced when the rates are set and are related to the utility's actual cost increases, the railroads benchmark their fuel adjustment to an arbitrary price index and use prices experienced in 2001 or 2002 regardless of when the transportation pricing was established and when and how the transportation pricing has been adjusted to account for cost increases.² AECC's specific concerns with the methodologies employed by the railroads to adjust rates for increased fuel costs include the following:

- ◆ The Board's RCAF is a common index used to escalate rail rates. The RCAF contains a significant component for the cost of fuel, calculated on the portion that fuel represents in the railroads' overall cost structure. The quarterly RCAF adjustments themselves take into account increases in fuel costs. The use of the RCAF in conjunction with a separate fuel surcharge results in a double recovery of increased fuel costs.
- ◆ UP's surcharge is applied to rates, not fuel costs. Rates include components for labor, overhead, profit and other factors not

² See note 3, *infra*.

affected by changes in fuel prices. Therefore, a high-rated movement, such as a movement to a captive plant, pays a higher fuel surcharge than an otherwise identical movement that has a lower base rate. This exacerbates the differential pricing issues already experienced by captive shippers, and plainly deviates from simple cost recovery.

- ◆ Both UP and BNSF use the price of On-Highway Diesel Fuel index as the benchmark for fuel surcharges. This price index is not directly related to the railroads' actual fuel costs. Moreover, this index is affected by taxes and multiple distribution chain mark-ups in addition to the costs for the diesel fuel itself.³ This will be exacerbated this coming Fall when On-Highway diesel fuel operators are required to comply with EPA requirements to phase-in ultra-low sulfur diesel for highway users. This is expected to increase both the distribution costs and price of on-highway diesel. The railroads, however, do not have to convert to ultra-low sulfur fuel until 2012. Continued use of the On-Highway Diesel Fuel index under these circumstances could exacerbate the over-recovery of costs for a period of several years, thereby creating a

³ CSX and NS use the price of West Texas Intermediate Crude Oil as their benchmark. This index too does not reflect the railroads' fuel costs or the increases to those fuel costs. In addition, NS announced on April 24, 2006 that it would increase the benchmark price used for its fuel surcharge program from \$23.00 per barrel of West Texas Intermediate Crude Oil to \$64.00 per barrel. The positive implication of this action was undermined, however, when the announcement also stated that tariff prices and public quotes are being adjusted, thereby suggesting that rate increases over the past four or five years have not compensated the railroad for its increased operating costs, including fuel.

further windfall for the Western railroads unless the fuel surcharge programs are otherwise adjusted.

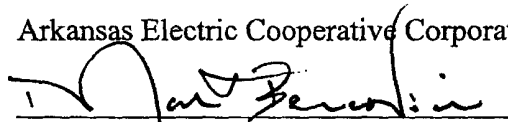
- ◆ The On-Highway Diesel Fuel index is a price index, not a true “cost” index. Use of such an index revives the concerns inherent in the RCAF regarding use of a price index which does not take into account the carriers’ true costs, which may be affected by productivity. While AECC does not wish for the Board to adopt policies that would discourage the railroads from pursuit of productivity enhancements, imposition of a surcharge to recoup increased costs is an extraordinary remedy, and so should be limited to true cost increases.
- ◆ The railroads report their fuel expenses to the Association of American Railroads (“AAR”), and the AAR publishes a monthly fuel index. The credibility of the fuel surcharge programs would be greatly enhanced if they were reconciled against the AAR figures.
- ◆ BNSF changed to a mileage based fuel surcharge program in January, 2006 for coal movements. While this addresses the high-rated vs. low-rated problem discussed above, in converting to a mileage-based program BNSF perpetuated its over-recovery of its increased fuel expenses by designing the new program to recover the same revenues as the rate-based surcharge.

AECC submits that it is both misleading and inappropriate for the railroads to impose fuel surcharges which not only are not related to the railroads' increased cost of fuel, but also that recovers more than the increased costs experienced by the rail carriers. The Board can and should address the railroads' fuel surcharge practices through its jurisdiction to regulate unreasonable practices, 49 U.S.C. § 10702. In analogous circumstances, the Federal Trade Commission has treated the use of benchmark pricing for transportation service which is unrelated to the actual service rendered and the costs incurred as an unfair and deceptive trade practice.⁴ A similar outcome should be applied here under the Board's unreasonable practice jurisdiction.

AECC appreciates the opportunity to share its views with the Board, and urges the Board to adopt rules setting forth guidelines, enforceable on complaint, to require that fuel surcharges are limited to those amounts necessary to recover the increased cost of fuel experienced by the railroad for the movements to which the fuel surcharges apply, and to preserve longer-term incentives for fuel efficiency improvement.

Respectfully submitted,

Arkansas Electric Cooperative Corporation



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⁴ See *International Paper Company*, 84 F.T.C. 9 (1974).