

April 27, 2006

Via Hand Delivery

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423



Re: Ex Parte No. 661; Rail Fuel Surcharges

Dear Secretary Williams:

Please find enclosed an original and ten (10) copies of the written testimony submitted on behalf of Mittal Steel in the above referenced proceeding. Also enclosed is a diskette with a copy of the filing in word format.

An extra copy of this filing is enclosed for stamping and returning to our offices.

If you have any questions or require additional information, please do not hesitate to contact me at (202) 331-8800.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jeffrey O. Moreno'.

Jeffrey O. Moreno

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Public Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 661
RAIL FUEL SURCHARGES

Written Testimony
submitted by
MITTAL STEEL USA



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Mittal Steel USA ("Mittal Steel") hereby submits these written comments in response to the Notice of Public Hearing issued by the Surface Transportation Board ("Board") in STB Ex Parte No. 661, *Rail Fuel Surcharges* (served March 14, 2006). Mittal Steel commends the Board for holding this public hearing and hopes that the information presented will enable the Board to help shippers ensure that they are paying fair and reasonable rail fuel surcharges.

Description and Interest of Mittal Steel

Mittal Steel is the largest steelmaker in North America. It has operations in 12 states with the capacity to produce 31 million net tons of raw steel. Its integrated operations at Indiana Harbor, Indiana constitute the largest steel plant in North America with 10 million tons of steelmaking capacity. Mittal Steel's other major production facilities are located in Cleveland, Ohio; Burns Harbor, Indiana; and Baltimore, Maryland. These include assets of the former LTV Steel Co, Bethlehem Steel Corp., Weirton Steel Corp., Acme Steel Co., and Georgetown Steel Corp.

Mittal Steel serves a broad U.S. manufacturing base. Its principal products include a broad range of hot-rolled, cold-rolled and coated sheets, tin mill products, carbon and alloy plates, wire rod, rail products, bars and semi-finished shapes to serve the automotive, construction, pipe and tube, appliance, container and machinery markets. Mittal Steel is the nation's leading producer of flat-rolled steel used for automobile exteriors and is a leader in the development and use of advanced high-strength steels that are crucial to safety systems and weight reduction in today's vehicles. In addition, Mittal Steel is a leader in the production of tin-plated sheet, including armor plate used in critical military applications.

Mittal Steel is a heavy user of rail, truck, vessel and barge transportation. In 2005, Mittal Steel transported over 65 million net tons of finished steel, semi-finished steel, raw materials, coal and coke via these modes. At more than 22 million net tons, rail accounted for over a third of this volume. Mittal Steel paid over \$257 million to rail carriers, including \$33.5 million in fuel surcharges. While Mittal Steel ships via all US and Canadian trunk line railroads, Norfolk Southern, CSXT and Canadian National haul a majority of its rail traffic. Several Mittal Steel facilities are captive. All three of the above mentioned carriers assess fuel surcharges based on a percentage of the transportation rate.

Comments

The objective of a surcharge should be to recover cost inputs that are subject to highly volatile pricing because of market conditions over which the supplier has little to no influence, so that commercial relationships can be preserved. The base rate agreed upon by the parties to a transaction should factor in all known and reasonably anticipated costs, plus a profit margin. If a cost factor is particularly volatile, however, a surcharge to address significant increases in that cost above and beyond the level factored into the base rate can help preserve the economic

relationship established by the base rate, since volatility makes it difficult for parties to anticipate changes in such costs as part of their normal commercial relationship. Therefore, parties often agree upon a surcharge methodology that allows the party that incurs the volatile cost to pass through some or all of an unanticipated cost increase to the other party.

Mittal Steel agrees that a fuel surcharge is necessary in today's highly volatile oil market, where prices have increased by 50% or more in very short time periods and are highly sensitive to supply shocks, such as hurricanes and foreign political unrest. But the fuel surcharges established by the North American railroad industry have no logical connection to these cost changes and have resulted in a substantial over-recovery of fuel costs, thus converting the fuel surcharge into a profit center for the railroads.

All but one of the major North American railroads apply a fuel surcharge based on a percent of the transportation rate. There is no rational connection, however, between a shipper's rate level and the additional fuel costs incurred to move the freight. Indeed, two shippers can transport a commodity on the same train between the same two points and be charged vastly different transportation rates. Although the additional fuel cost for each movement would be identical, the shipper who pays the higher rate also pays a much higher fuel surcharge. As fuel costs continue to set new records, this discrepancy is only aggravated.

Several groups, including the National Industrial Transportation League ("NITL"), commissioned a study of rail surcharges in 2004 to examine the relationship of the various fuel surcharge methodologies used by Class I railroads to their costs and revenues. The study concluded that rail customers typically are paying substantially more in fuel surcharges than the railroads are incurring in higher fuel costs for each movement. For example, CN, one of Mittal

Steel's primary carriers¹, incurred a 12.5% increase in fuel costs per car from 4Q01 to 1Q04, while collecting a 49.1% increase in fuel surcharge revenue per car over the same time period. The Study also predicted that this trend would continue at an accelerated pace in 2005, which has turned out to be true. This excess recovery increases the railroads' profit margin on each movement.

Based on the limited data available to it, Mittal Steel has every reason to believe that it is overcompensating CN in fuel surcharge payments. For example, in January 2005, CN published a fuel surcharge of 12%. CN's Annual Report provides annual average fuel prices, annual gross ton miles per gallon of fuel consumed, and the ratio of fuel expense to total operating expenses. Comparing this data from 2004 to 2005, CN's fuel expenses increased by 32% and fuel represented 16% of CN's operating expense.² Thus, 32% of 16% suggests that only a 5% fuel surcharge was warranted in 2005 compared to CN's actual fuel surcharge of 12%. If CN's increased fuel cost for Mittal's movements truly was greater than 5%, the burden should be on CN to support this additional amount.

Indeed, recent CN actions strongly suggest that it is intentionally using its fuel surcharge to disguise rate increases. CN has published two tariffs with distinctly different fuel surcharges, a higher surcharge in CN 7400 and a lower surcharge in CN 7401-A. The only explanation given by CN for the different tariffs is that "customers with published contractual agreements related to the former fuel surcharge tariff 7400 will have no immediate change until those agreements expire...." There does not appear to be any traffic distinction, transportation characteristic, or other cost-based factor to otherwise distinguish the traffic to which each tariff

¹ The Canadian National Railroad provides a large percentage of Mittal Steel's raw material rail transportation needs by transporting taconite iron ore from Mittal Steel's Minorca Mine in Minnesota via the former Duluth, Missabe & Iron Range Railroad ("DMIR") and the Wisconsin Central Railroad ("WC") lines to lake vessels at the ports of Duluth, Minnesota, and Escanaba, Michigan.

² Canadian National 2005 Annual Report, pp. 44 and 70.

applies. While the CN's stated intent to eventually move all traffic to the lower CN 7401-A tariff is commendable, it is a tacit admission that there is no cost basis for the continued application of the higher CN 7400 fuel surcharge. If the CN 7401 surcharge is adequately compensating CN for changes in fuel costs, the higher CN 7400 surcharge is yielding wind-fall revenue to CN on traffic to which that tariff still applies.³

A surcharge is not, and should not be, a profit center. The base rate for the transaction agreed upon by the parties establishes the profitability of the transaction. A surcharge is intended to preserve that relationship by preventing significant increases in a volatile cost factor from eroding the economic benefits of the transaction to the party that incurs the cost. If a surcharge were to recover more than the change in cost, it would re-write the commercial relationship to the gain of the party that incurs the cost. Perversely, the surcharge then would undo the very same commercial relationship that it is intended to preserve.

This is of particular concern in the rail industry where the commercial relationship has become increasingly one-sided in favor of the railroads. A fuel surcharge that over-recovers the actual increase in fuel costs for a movement is actually a rate increase disguised as a surcharge. Due to the market leverage that railroads possess, particularly over bulk shippers such as Mittal Steel, these surcharges are presented as a "take it, or leave it" proposition. Since Mittal Steel is captive to rail for a large percentage of its rail tons, it has no real choice but to pay the surcharge even though it is apparent that Mittal Steel is paying more than the actual increase in fuel costs to

³ Although contracts are not within the Board's jurisdiction, that fact does not alter the conclusion that the fuel surcharge lacks any basis in actual costs, since there is nothing to suggest that the cost characteristics of traffic under the CN 7400 tariff differ from traffic under the CN 7401-A tariff. The only difference appears to be whether the traffic is subject to a contract entered into prior to the CN 7401-A tariff. Since contracts are not within the Board's jurisdiction, CN apparently has concluded it can over-recover fuel surcharges from those customers without consequence.

move its traffic. Furthermore, even when Mittal Steel has a choice of rail carriers, the oligopolistic behavior of the industry precludes a truly competitive alternative.

In contrast, Mittal Steel regularly negotiates the fuel surcharges assessed by its motor carriers. The competitive structure of the motor carrier industry, and the relative ease of market entry, give Mittal Steel competitive options when a carrier's fuel surcharges get out of line with its actual costs.

In addition, motor carrier fuel surcharges are more transparent, which allows an over-recovery to be easily and accurately identified. This is because motor carriers are much more responsive with data to support their requests for fuel surcharge modifications. Typically, the motor carriers used by Mittal Steel have established a base fuel cost of \$1.20/gallon of diesel, above which a fuel surcharge applies. They peg their fuel surcharge to changes published by the Department of Energy's Energy Information Administration. Assuming a specified fuel efficiency rating for a carrier or movement, Mittal Steel can analyze data to readily determine if it is adequately compensating motor carriers for their increased fuel costs.

Fuel surcharges in Mittal Steel's contracts with Great Lakes carriers also are transparent. They specify the base fuel cost assumed in the rate and provide a mechanism for recovering (or refunding) changes in the carriers' fuel costs. The fuel surcharge methodologies either identify a fixed dollar amount in the base rate that represents fuel and adjusts that amount by the ratio of actual fuel prices to the base fuel price, or they specify a ratio of a cents-per-ton change in the freight rate to a cents-per-gallon (or ton) change in fuel prices. Both methodologies can be related to the actual fuel use (and thus the cost change) for the movement in question.

With sufficient data from the railroads, there is no reason why similarly transparent methodologies could not be adapted for the rail industry. First, such data should include fuel

consumption in gallons per net ton of various commodity types. Because fuel consumption is likely to vary between heavy weight commodities (*e.g.*, coal, iron ore) and lighter weight commodities (*e.g.*, intermodal), distinctions in a fuel surcharge may be warranted. Other relevant factors could include train size and train type (*e.g.*, unit train, manifest).

Second, the railroads should establish a base cost of fuel in dollars per gallon and they should track the actual cost of fuel in dollars per gallon. The West Texas Intermediate Crude Oil prices, favored by the Eastern railroads, is not a diesel fuel price at all and it is quoted in dollars per barrel of oil. The On-Highway Diesel Fuel price, favored by the Western railroads, includes taxes and additional mark-ups that the railroads do not pay. A more appropriate measure is the U.S. diesel sold in wholesale markets to "commercial and institutional consumers," reported by the Energy Information Administration of the Department of Energy. These diesel prices more fairly reflect the actual spot market prices of the fuel that railroads are purchasing.

Respectfully submitted,



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Dated: April 27, 2006

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