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April 27, 2006

VIA E-FILING

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

**RE: Comments of Cemex, Inc. in response to Rail Fuel Surcharges, Ex
Parte No. 661 (STB served Mar. 14, 2006).**

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are the Comments of Cemex, Inc.

Yours very truly,



Sandra L. Brown

SLB:kjm
Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 661

REVIEW OF RAIL FUEL SURCHARGES

COMMENTS OF CEMEX, INC.

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ATTORNEYS FOR CEMEX, INC.

April 27, 2006

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 661

RAIL FUEL SURCHARGES

COMMENTS OF CEMEX, INC.

I. INTRODUCTION

The Surface Transportation Board's ("STB" or "Board") decision served March 14, 2006 in this proceeding provided notice of a public hearing to be held on May 11, 2006 and request for testimony to address fuel surcharges collected by railroads (hereinafter "Notice"). CEMEX, Inc. ("CEMEX") hereby submits comments in response to the invitation in the Notice.

A. Identification and Interest of CEMEX, Inc.

CEMEX is part of the U.S. division of CEMEX SA, de CV, a Mexico-based international construction materials company. CEMEX is the largest cement, fly ash, and ready-mix company in the United States, and one of the leading producers of limestone aggregate – sand, gravel, and crushed stone – both within the U.S. and worldwide. CEMEX's aggregate products are used in everything from ready mixed concrete and concrete products to sand blasting and golf course landscaping. CEMEX currently operates 12 cement plants, 48 strategically located distribution terminals, 283 ready-mix plants, and 49 construction aggregate quarries.

Due to its size and diversity of products, CEMEX spends hundreds of millions of dollars on its transportation budget each year. It is a major shipper of limestone aggregates, coal, Portland cement, and fly ash. It ships these and other commodities on all of the major Class I

railroads, particularly the Union Pacific Railroad ("UP"), the BNSF Railway Company ("BNSF"), the Norfolk Southern Railway ("NS"), and CSX Transportation, Inc. ("CSXT"). These four major railroads transport 90% of the United States freight shipped by rail. Most of CEMEX's rail movements are subject to the fuel surcharges established by the railroads in pricing circulars and other public documents setting forth their common carrier terms for providing coal transportation service.

B. The Commodity Exemption Applicable to Aggregates Should Not Cause the Board to Ignore CEMEX's Concerns.

The aggregates shipped by CEMEX are currently subject to a commodity exemption from Board regulation under 49 CFR § 1039.11. Nevertheless, the Board should still seriously consider CEMEX's comments. First of all, CEMEX is an active shipper of non-exempted commodities such as coal. Second, carriers of exempt commodities are still subject to the Board's reporting requirements. Third and most importantly, the Board should give serious consideration to eliminating the aggregates exemption. The purpose of exempting a commodity such as aggregates from Board regulation is largely based on the presumed intermodal competition that provides a transportation alternative for shippers. *Rail General Exemption Authority – Miscellaneous Manufactured Commodities*, Ex Parte No. 346 (Sub-No. 24), 6 ICC2d 186, 191 (1989) (ICC notes that an exemption was "carefully narrowed...to include only commodities for which there are adequate intermodal alternatives to assure competitive transportation"). Any previous rationale that may have existed for the aggregates exemption is now tenuous because trucking is not a viable alternative for shipping aggregates for all but short distances because materials such as aggregates, cement, and fly ash are high weight to low value bulk products. Accordingly, the motor carrier industry is not interested in such shipments for a

number of reasons, including: (1) a national shortage of drivers; (2) highway congestion; and (3) high fuel prices, which affect trucks even more than railroads.

C. Summary of Comments

CEMEX is not opposed to the Class I railroads recovering the fuel costs associated with CEMEX's movements. In fact, CEMEX would support a mileage-based fuel surcharge that accurately reflects market prices for diesel fuel. However, the major Class I railroads have significantly over-recovered the fuel costs they incur for providing service to CEMEX through the assessment of fuel surcharges. Railroad fuel surcharges find little support in agency precedent generally, and the current fuel surcharges assessed by the major railroads constitute an unreasonable practice under 49 U.S.C. § 10702 because these fuel surcharges are clearly rate increases as opposed to mechanisms to recover temporary spikes in fuel costs for particular movements.

The Board should establish narrow, cost-based standards for permitting railroad fuel cost recovery methods that, if anything, permit the railroads to only recover significant, short term increases in fuel costs. These standards should recognize that the Board's established Rail Cost Adjustment Factor ("RCAF") mechanism for recovering fuel costs enables the carriers to fully recover their costs of fuel for a particular movement, and that the Board's predecessor determined that fuel surcharges were unnecessary when rates are adjusted using the RCAF. The Board should also recognize that the recent use by individual railroads of the All-Inclusive Index Less Fuel ("AIILF") developed by the Association of American Railroads ("AAR") in conjunction with a fuel surcharge in lieu of the RCAF is not an alternative or industry practice arrived at via mutual agreement by shippers and railroads. Rather the advent of the AIILF in recent years is more a reflection of the significant market power and negotiating leverage

currently possessed by the Class I railroads. Use of the AILF also undermines the goals of the ICC and Board in creating and administering the RCAF.

In this proceeding, the Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate; (2) find that rail fuel surcharges are unreasonable practices in violation of 49 USC § 10702; (3) establish narrow standards for the temporary imposition of fuel cost recovery mechanisms for the sole purpose of recovering actual costs of fuel expended for a particular shipper's transportation that are not recouped by other means; and (4) require each railroad to submit detailed data reflecting their actual cost of fuel and the revenues associated with fuel cost recovery.

II. STB HAS AUTHORITY TO REVIEW RAILROAD FUEL SURCHARGES

A. Prior Regulatory Treatment of Fuel Surcharges

1. The *Ex Parte No. 311* Proceeding

This proceeding is not the first time fuel surcharges have come to the attention of federal regulators, or the first time railroad fuel surcharges have been questioned for over-recovering fuel costs. Prior to passage of the Staggers Rail Act of 1980¹ and the adoption of the RCAF as discussed below, railroads had to seek prior approval of any rate increases. Any approved increases could not go into effect for 30-45 days.² When fuel prices increased significantly as a result of the Middle East oil embargo in 1973, the Interstate Commerce Commission ("ICC") determined that the existing process for general rate increases, including the 30-45 day waiting period, "may not be adequate in the present circumstances to offset anticipated increases in fuel prices."³ It commenced a proceeding in order to allow railroads and motor carriers to increase

¹ Staggers Rail Act of 1980, 96 P.L. 448 (Oct. 14, 1980).

² See former 49 USC § 10762, as described in, e.g., *The Hanna Mining Company v. The Escanaba and Lake Superior Railroad Co.*, 498 F.Supp. 1267, 1269 (E.D. Mich. 1980).

³ 40 Fed. Reg. 5374 (1975).

transportation rates more expeditiously. *Ex Parte No. 311, Effect of Modifying Proclamation No. 3279 and Other Anticipated Energy Conservation Measures on the Operation of Carriers Subject to the Interstate Commerce Act*, 350 ICC 563, 564 (1975) (“*Ex Parte No. 311*”). After a comment period, the ICC adopted expedited procedures providing interim relief from the regular 30-day notice required, but only if fuel prices were to escalate in the future as expected. *Id.* at 567.

In allowing this interim relief, the ICC declined the use of fuel surcharges. Specifically, the ICC had permitted the imposition of fuel surcharges on an “experimental basis” in 1973-74, primarily for motor carriers. *Id.* at 566. In *Ex Parte No. 311* the ICC clarified that “it has been the traditional view of this Commission that surcharges which add an element of confusion into tariff use should only be sanctioned in unusual situations. Generally, surcharges have only been considered as appropriate in situations where it is anticipated that their use will be of temporary duration or where in extenuating situations the service performed under the surcharge is considered local to the carrier assessing the charge.” *Id.* at 572 (emphasis added). Lastly, the ICC noted that while the price of fuel appeared as if it would remain higher for the foreseeable future, “the surcharge method of computing freight charges” was not an appropriate way to increase rates permanently. *Id.*

Because the ICC did not implement the expedited procedures adopted in *Ex Parte No. 311* until 1979 and railroads did not begin recovering the high fuel costs of 1973-74 until June of 1979, the ICC in 1980 approved a 1.2% railroad fuel surcharge instituted as a general rate increase. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge*, April 11, 1980, 364 ICC 336 (1980). In this decision, the ICC utilized the *Ex Parte No. 311* procedures (“even though...created for different purposes”) because they represented the “best way to

consider a fuel related surcharge.” *Id.* at 337-338. Although the ICC initially declined to adjust the application of the surcharge on an individual shipper basis, in response to a successful appeal by Central Power & Light Company, the ICC removed the 1.2% surcharge as applied to that shipper because it shipped no traffic during the period in question. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge, April 11, 1980*, 365 ICC 299 (1981). The ICC eventually permitted a total of 4.7% of such surcharges to account for the delay in implementing *Ex Parte No. 311*. ICC Docket No. 37316, *Rates on Coal, Decker and Kleenburn to Illinois and Indiana*, 364 ICC 158, 160 (1980) (“*Rates to Indiana and Illinois*”) (describing ICC use of *Ex Parte No. 311* to authorize a fuel surcharge of 4.7% in the first nine and a half months of 1979). In several instances, railroads tried to apply the 4.7% increase to individual movements that were already subject to existing rate and rate escalation arrangements. In these cases, however, the criteria utilized by the ICC to determine whether application of the surcharge was appropriate included whether the revenue generated by the surcharge was justified by the actual fuel costs incurred by the railroad or railroads to provide the service to that particular shipper or group of shippers. *Id.*, 364 ICC 158 (1980); and ICC Docket No. 37315F, *Coal, Colstrip, Kuehn, and Decker, MT to Superior, WI*, 364 ICC 152 (1980). In the latter case, the ICC noted in particular that the railroad did not demonstrate that it would be harmed by waiting until it recovered the additional fuel costs for that movement through operation of the rate adjustment provision that had been agreed upon by the parties. *Id.* at 156.

Prior to the passage of the Staggers Rail Act of 1980 and the development of the RCAF, the ICC permitted fuel surcharges in very narrowly prescribed circumstances to permit recovery of extraordinary and temporary increases in fuel costs prior to recovering such costs in rate increases or through a rate adjustment provision. Moreover, attempts to broadly apply

surcharges to individual movements required some showing that the revenues generated by the surcharge did not exceed the actual fuel costs.

Finally, CEMEX notes that one of the railroads' justifications for assessing fuel surcharges on new transportation is that some traffic moves under contracts that do not permit full fuel cost recovery. The fact that the United States had several fuel crisis' in the 1970s provided the railroads with notice that adequate protections for fuel cost spikes should have been built into subsequent contracts. The fact that such protections may not be present in some contracts is no justification for forcing other shippers to subsidize such movements.

2. The Effect of the Adoption of the Rail Cost Adjustment Factor on Fuel Surcharges

In part at the behest of Congress, the ICC proposed in 1980 to replace the procedures for filing general rate increases with a procedure based on an inflation index, the RCAF. *Advance Notice of Proposed Rulemaking*, 45 Fed. Reg. 29103 (May 1, 1980). In publishing the proposed rules, the ICC stated that "the procedures proposed in this notice will permit railroads to recover fuel cost increases along with other cost increases on a quarterly basis...We thus propose that our current *Ex Parte No. 311* fuel surcharge mechanism be discontinued." *Ex Parte No. 290* (Sub No. 2), *Railroad Cost Recovery Procedures* 45 Fed. Reg. 81217 (Dec. 10, 1980).

The ICC adopted the newly-created RCAF railroad index just a few months later in April of 1981. *Ex Parte No. 290* (Sub-No. 2), *Railroad Cost Recovery Procedures*, 364 ICC 841 (1981). According to the ICC, adoption of this index "permit[s] railroads to recover fuel cost increases along with other cost increases on a quarterly basis." *Id.* at 852. Furthermore, the RCAF meant that "[m]aintaining a separate surcharge mechanism for fuel would, in our view, serve no useful purpose once these rules are in place, and would, in fact, only complicate the operation of the new system." *Id.*

A few years later, the ICC adopted a revised methodology for the RCAF index based on data gathered and submitted by the Association of American Railroads ("AAR"). Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, 1 ICC2d 207 (1984). In stating again that the creation of RCAF was in response to the Staggers Act, the ICC noted that "[w]e believe it was the intent of that Act to simplify the procedures for increasing rail rates and that the application of the single RCAF to all base rates best accomplishes that intent." *Id.* at 208. For the fuel component of the RCAF, the ICC considered a variety of shipper proposals but eventually decided that the survey of actual prices paid by railroads, which was prepared by the AAR, was the best measure of the price of railroad diesel fuel. *Id.* at 217-218.

These statements from the ICC reveal that the RCAF was intended to not only replace the general rate increase method of adjusting rail rates with a simpler method, but also to supplant the need for fuel surcharges. Shippers and the AAR proposed competing methods of incorporating the price of fuel into the RCAF, but the ICC chose the AAR's method. In other words, in response to the ICC's request for rate adjustment methods that would replace the fuel surcharge mechanism, the railroads developed a method for incorporating fuel price that was approved by the ICC. Any change to this railroad-proposed and ICC-approved mechanism for incorporating fuel price in rates should only come in regulatory rulemaking.

The RCAF index is based on quarterly filings made by the AAR. These filings include a forecasted railroad fuel cost for the next calendar quarter which is a mix of (1) actual diesel prices paid by railroads (for the weighting component) and (2) various projections by the major railroads' fuel purchasing officers and others regarding the level of railroad diesel prices during the next quarter.⁴ These quarterly filings reveal that the RCAF methodology takes into account

⁴ See generally "Rail Cost Adjustment Factor," a publication from the Association of American Railroads (November 2001).

the fluctuation of railroad diesel prices caused by events in the world oil markets. For example, the filing made on December 5, 2005 by the AAR described the damage done by hurricanes Katrina and Rita as largely responsible for the rise in the fuel component of the RCAF. Ex Parte No. 290 (Sub-No. 5) (2006-1), *Quarterly Rail Cost Adjustment Factor* AAR forecast, Appendix B (page 1), (filed Dec. 5, 2005). These are exactly the same reasons now cited by the railroads in justifying the use of their privately developed fuel surcharges.

In adopting the methodology for calculating the RCAF, the ICC stated that "significant problems in the accuracy of fuel data" could warrant a change in the fuel component of the RCAF index. *Railroad Cost Recovery Procedures*, 1 ICC 2d at 218. In other words, there is a standing invitation to all parties to petition the Board for a change in the RCAF if they feel it does not accurately reflect their fuel costs. This action is more preferable than the railroads' exertion of their market power to adopt fuel surcharges that are clearly designed to enhance the overall revenues of the railroad rather than simply enable the recovery of short term spikes in fuel costs. Indeed, the excessively high fuel surcharges implemented by the major Class I railroads is proof that insufficient competition exists between railroads today. If sufficient competition was present, market forces would constrain the practices of the railroads and their exertion of monopoly power.⁵

A further example of the railroads' market power in recent years is shown by the shift of some railroads away from using the RCAF to utilizing the AAR's All-Inclusive Index Less Fuel ("AAILF") in rail transportation contracts. Unlike the RCAF, the AAILF has not been formally approved by the Board, meaning the railroads, through the AAR, can change the index without seeking the Board's permission and circumvent the RCAF as a means of justifying separate fuel

⁵ CEMEX notes that out of more than 100 active rail routes it can use to ship its products, rail-to-rail competition at origin and destination exist on less than five of the routes.

surcharges that over-recover fuel costs. Under this scenario, the tariff “fuel surcharge” is not a true “surcharge” at all, but rather a separately established mechanism to adjust all changes in the railroad’s fuel costs. However, as shown below, the actual formulas used in the individual surcharges and their low thresholds for application virtually guarantee the railroads will receive additional revenue from their customer even if the cost of fuel for the movement does not increase over the term of the movement.

B. The Lawfulness of Railroad Fuel Surcharges Should be Reviewed Pursuant to the Board’s Authority under 49 U.S.C. § 10702 Governing Unreasonable Practices.

In its Notice, the Board stated that a surcharge is a “separately identified component of the total rate that is charged for the transportation.” Notice at 2. The Board went on to suggest that this proceeding is not meant to address the “level” of surcharges because the Board only has limited authority, in very specific instances, to regulate railroad rates. The Board stated in the Notice that railroad use of a fuel surcharge might be an unreasonable practice if the railroad disguises a rate increase as a “fuel surcharge” when such increase is not directly and closely correlated to increases in the cost of fuel for the particular movement to which the surcharge is applied. *Id.* The Board also stated that this proceeding should properly concern “whether railroad fuel surcharges are being set in such a manner as to insure that they are used only to recover the increased cost of fuel for the particular movements to which the surcharge is applied” *Id.*

While the ICC decisions referenced above discuss the ICC’s treatment of fuel surcharges, there is no clear Board precedent on this particular subject. Specifically, there is no precedent stating definitively whether the Board considers a fuel surcharge to be part of the rate for transportation or a “rule” or charge whose reasonableness can be challenged independent of the

transportation rate. This lack of clear guidance is evident from filings in recent cases. For example, in STB Docket No. 42072, *Carolina Power & Light v. Norfolk Southern Railway Company*, the parties disagreed over whether NS could assess a fuel surcharge on top of a maximum reasonable rate prescribed by the Board in a case brought under the *Coal Rate Guidelines Nationwide*.⁶ While CP&L had claimed that all fuel costs had already been incorporated into the stand-alone cost ("SAC") analysis and prescribed rates over the DCF period, NS claimed the surcharge was a separate "rule" that had not been separately challenged by CP&L and, therefore, was not at issue in the case. Docket No. 42072, NS Statement of Position at 2 (filed June 4, 2004). The Board did not resolve this question in *CP&L*. Docket No. 42072 *CP&L v. NS*, at 6 (served Oct. 20, 2004). The same general question has been posed to the STB in other SAC cases, but no answers have been provided. See, e.g., *Western Fuels Association v. Burlington Northern Santa Fe Railway Company*, Docket 42088 (complaint filed October 1, 2004); *Kansas City Power & Light Company v. Union Pacific Railroad*, Docket No. 42095 (complaint filed October 12, 2005). Thus, there is a need for the Board to review the railroad fuel surcharge practices.

1. The Assessment of Fuel Surcharges is a Railroad Practice Subject to the Board's Jurisdiction.

Under 49 U.S.C. §§ 10702 and 10704(a)(1), the Board has authority over railroad practices. If a railroad practice is found to be unreasonable, the Board can order the railroad to cease engaging in it or the Board can prescribe the "practice to be followed." 49 U.S.C. § 10704(a)(1). Whether or not a particular railroad practice is unreasonable requires the Board to engage in a "fact-specific inquiry" to be conducted on a "case-by-case" basis. *WTL Rail*

⁶ 1 ICC2d 520 (1985).

Corporation – Petition for Declaratory Order and Interim Relief, Docket No. 42092 at 6 (served February 17, 2006).

The fuel surcharges established by Class I railroads that provide transportation service to CEMEX's facilities are usually contained in publicly available rules or tariffs and incorporated by reference in a coal transportation contract or pricing authority. CEMEX, like other shippers, has no choice but to accept the fuel surcharge terms in whatever pricing method is used. Therefore, it is very important that the Board address the fuel surcharge issue and adopt standards for when and how fuel surcharges can be applied because such standards will affect subsequent rate negotiations for rail transportation to CEMEX's various facilities.

It is clear that surcharges are universal rules or charges subject to Board jurisdiction as "transportation-related" practices such as demurrage. *Capitol Materials Incorporated – Petition for Declaratory Order – Certain Rates and Practices of Norfolk Southern Railway Company*, Docket No. 42068 at 2 (served April 12, 2004). The manner in which the railroads calculate and assess their individual fuel surcharges is subject to a determination of reasonableness under 49 U.S.C. § 10702. In order to ensure that railroad practices are reasonable, the Board has previously used its authority under 49 U.S.C. § 10702 to assert jurisdiction over various other railroad rules and surcharges. The Board has evaluated the specific demurrage charges assessed against a shipper under the unreasonable practice standard. *Capitol Materials* at 6. The Board has found a light-density line surcharge to be an unreasonable practice when used in conjunction with contract service. STB Docket No. 42031, *Parrish & Heimbecker, Inc. – Petition for Declaratory Order* at 9 (served May 26, 2000). The Board has begun a proceeding to evaluate whether BNSF's imposition of storage and demurrage charges on all types of empty private cars awaiting loading is an unreasonable practice. *North America Freight Car Association – Protest*

and Petition for Investigation – Tariff Publications of the Burlington Northern and Santa Fe Railway Company, Docket No. 42060 (Sub-No. 1) at 9 (served August 13, 2004). The Board has also evaluated whether it was unreasonable for a railroad to limit the hours its track could be used by a second railroad under a trackage rights agreement. *Granite State Concrete Co., Inc. and Milford-Bennington Railroad Company, Inc. v. Boston and Maine Corporation and Springfield Terminal Railway Company*, Docket No. 42083 at 1 (served September 24, 2004).

2. Individual shippers should be able to bring individual challenges to specific fuel surcharges without using the Board's rate reasonableness procedures.

As shown, the Board can evaluate the Class I railroads' general fuel surcharges under the unreasonable practice standard of 49 U.S.C. § 10702. A fuel surcharge is a universally-applicable tariff item that exists independently of the rate. As the Board recognized in the Notice, a fuel surcharge is reasonable only if it "fairly reflect[s] the increasing fuel costs of the particular movements to which [it is] applied." Notice at 2. There is no need for a stand-alone cost or other rate analysis to make this determination. For example, the Board has previously determined the reasonableness of a particular demurrage charge without resort to rate reasonableness standards. *Capitol Materials* at 4 (finding a \$60 per day demurrage charge to be reasonable without resort to the rate reasonableness standards). The determination of whether a purported fuel surcharge fulfills its cost recovery purpose can be aided by the submission of fuel cost and revenue data by the railroad(s) seeking to assess the fuel surcharge.

III. THE FUEL SURCHARGES IMPOSED BY CLASS I RAILROADS ARE REVENUE ENHANCEMENT MECHANISMS

Although CEMEX is served by all of the major North American railroads, for purposes of these comments CEMEX is addressing the surcharges implemented by UP and BNSF. The fuel surcharges implemented by NS and CSX use a different fuel index as their baseline, but the

basic operation of the eastern railroads' fuel surcharge practices is similar to the UP and BNSF, as well the deficiencies.

A. BNSF's Fuel Surcharge in Item 3380

Item 3380 imposes a fuel surcharge on Coal Unit Trains and Trainload Shipments which is calculated by applying a percentage increase to the overall transportation rate. According to BNSF, the "fuel surcharge will be applied to the total freight charges for each shipment waybill dated on or after the 1st day of the second following calendar month." *BNSF Rules Book 6100-A, Item 3380*. The fuel surcharge will be included in the freight charges for each assessed shipment. Fuel surcharge rates will be adjusted monthly and calculated according to the U.S. Average Price of Retail On-Highway Diesel Fuel ("HDF") when the month of the second prior month equals or exceeds \$1.24 per gallon. For example, when the Time Period's Average Price of HDF is between \$1.96 and \$1.999 the applicable surcharge rate would be 9.5% of the total freight charges. When the U.S. National Average Fuel Index exceeds \$1.999 per gallon, the fuel surcharge rate will increase by 0.5% for every \$0.04 per gallon increase. BNSF provides the example of a fuel surcharge applied to shipments during the month of July. This example assumes the prior time period's May average monthly price of HDF was \$1.338 per gallon, therefore calculating the July's fuel surcharge as 1.5%. "Thus, for each \$10.00 of freight charges applicable to a shipment, the Fuel Surcharge would be \$0.15." *Id.*

Item 3380 is a revenue-based fuel surcharge. According to BNSF, the fuel surcharge is intended to allow BNSF to recover its fuel costs due to diesel fuel market volatility. Nevertheless, BNSF admits that its fuel surcharge pricing is market-based not cost-based.⁷ This "pricing" includes the imposed fuel surcharge.

⁷ <http://www.bnsf.com/tools/prices/fuelsurcharge/faqs.html#20>

B. BNSF's Mileage-Based Fuel Surcharge

BNSF's Mileage-Based Fuel Surcharge is calculated by multiplying the fuel surcharge per mile times the number of miles per carload per shipment.⁸ The mileage-based fuel surcharge is determined by using the U. S. Average Price of Retail On-Highway Diesel Fuel ("HDF"), the same fuel pricing table as used in Item 3380. "Mileage calculations will be based on BNSF Railway Miles between shipments' billed origin and destination as published on BNSF web page titled "BNSF Coal Unit Train and Trainload Mileage Table."⁹

The mileage-based fuel surcharge was targeted to be implemented on certain agricultural and coal traffic beginning on January 1, 2006. According to BNSF, railroads have traditionally applied a fuel surcharge based on a percentage of revenue to be gained from each shipment. However, during this time of high fuel prices, BNSF admits that a fuel surcharge based on percentage of revenue has and will continue to create significant disparities between the fuel surcharge assessed and their actual incremental fuel costs.¹⁰ The mileage-based fuel surcharge program is BNSF's attempt to "better align the fuel surcharge assessed...with the actual incremental fuel cost of transporting...goods."¹¹

While distance may be a better proxy for the amount of fuel used in a movement than the transportation rate, it still is unnecessarily imprecise. The use of distance ignores a variety of factors that affect fuel usage, such as topography, train weight, train speed, frequency of stops, and the time required for the movement. The mileage-based surcharge also suffers from the same basic deficiency as Item 3380 in that it uses as a baseline a fuel price that (1) has no

⁸ Coal Mileage-Based Fuel Surcharge: http://www.bnsf.com/tools/prices/fuelsurcharge/pdf/coal_mileage.pdf

⁹ "BNSF Railway Miles" is a calculation of miles a carload is transported in the loaded direction. This calculation can be performed on the BNSF website. Also, see the "BNSF Coal Unit Train and Trainload Mileage Table."

¹⁰ Frequently Asked Questions: BNSF Mileage-Based Fuel Surcharge:
<http://www.bnsf.com/tools/prices/fuelsurcharge/faqs.html>.

¹¹ *Id.*

relation to BNSF's actual fuel costs; and (2) is not reflective of the current cost of diesel fuel, thereby guaranteeing the surcharge will be assessed. These fuel surcharge practices therefore do much more than provide recovery of fuel costs during temporary price spikes. They also provide significant additional revenue to the railroads.

C. Summary of UP Item 690

Item 690 in UP Circular 6603-A describes the fuel surcharge UP has established for common carrier shipments made pursuant to the Circular. UP states that Item 690 is an attempt to recover incremental costs for diesel fuel and has been included as a result of the volatility in the diesel fuel market. This fuel surcharge is often incorporated by reference into transportation contracts.¹² Similar to the BNSF fuel surcharge, the UP surcharge is applied to line haul freight charges when the average price of Retail Highway Diesel Fuel ("HDF") calculated monthly, equals or exceeds \$1.35 per gallon. When this threshold is met, a fuel surcharge of 1.5% times the line haul rate is triggered. For every five cent increase above \$1.35 per gallon, the multiplier increases 0.5%. The fuel surcharge is applied to the freight charge for each shipment having a bill of lading dated on or after the 1st day of the second calendar month following the month with the HDF price increase. The average price is determined by adding the weekly HDF and dividing the result by the number of weeks reported, rounded to the nearest cent. The freight charge will never be reduced below the base freight charge as a result of applying the fuel surcharge. Also, the application or the removal of the fuel surcharge will not be retroactive.

D. BNSF's and UP's Fuel Surcharges Do Not Measure Actual Fuel Costs

Item 3380 and Item 690 both over-compensate actual fuel costs. As shown in Appendix A, various publicly-available statements support the finding that BNSF's, UP's, NS's and CSX's

¹² "The surcharge in this item applies to those agreements that indicate they are subject to this circular by reference unless that same agreement contains either a fuel surcharge or a specific rate adjustment mechanism that is tied to the RCAFU or other index that contains a fuel component." See *UP Circular 6603, Item 690, 3rd Revised Pg. 24*.

fuel surcharges are revenue enhancement mechanisms rather than measures of actual fuel costs. In addition, the HDF is not an accurate estimate of the price BNSF and UP pay for fuel. In the first place, use of the HDF monthly average as a basis for the surcharge is not representative of actual fuel costs because the HDF is a retail price index and railroads do not purchase locomotive fuel in that manner. Like all the other Class I railroads, UP and BNSF both buy diesel fuel in bulk and pays wholesale prices, not retail prices for their fuel. In addition, as discussed below, railroads are in a position to engage in large scale hedging on fuel.

Item 3380 does not measure actual fuel costs, but instead is applied when the HDF monthly average equals or exceeds \$1.24 per gallon. However, the HDF has not been at or below that level since March 2002.¹³ Furthermore, BNSF buys diesel in bulk at wholesale prices, not retail prices for fuel. Thus, HDF is not an accurate estimate of either the price BNSF pays for fuel or the changes in that price. For example, BNSF's average cost for diesel fuel in 3rd Quarter 2003 was \$0.864 per gallon and its average cost of diesel fuel for 3rd Quarter 2004 was \$0.988 per gallon.¹⁴ BNSF cost of fuel increased 14.4% from 3rd Quarter 2003 to 2004. In contrast, the HDF 3rd Quarter 2003 price was \$1.46 per gallon and \$1.83 per gallon in 3rd Quarter 2004, amounting to a 25.3% increase. Due to this disparity in increase percentages, BNSF shippers paid 11% more than the actual price BNSF paid for fuel from 3rd Quarter 2003 to 2004 because Item 3380 is tied to the HDF threshold. BNSF's fuel surcharge program also results in over-recovery of fuel costs because it ignores the 9% fuel efficiency improvement achieved by BNSF over the past ten years.¹⁵

Along the same lines, Item 690 clearly does more than permit UP to recover temporary spikes in the cost of fuel for a particular rail movement. In the first place, use of the HDF

¹³ See <http://tonto.eia.doe.gov/dnav/pet/hist/ddr001m.htm>

¹⁴ BNSF Investors' Reports available at www.bnsf.com

¹⁵ BNSF 2005 Annual Report at 13.

monthly average as a basis for the surcharge is not representative of actual fuel costs because the HDF is a retail price index. As noted above, UP buys diesel fuel in bulk and pays wholesale prices, not retail prices for its fuel. In 2005, UP paid an average of \$1.77 per gallon of diesel, but the average HDF price used in Item 690 during the year was \$2.40 per gallon. UP's 2005 Annual Report at 26.¹⁶ Moreover, due to the fact that Item 690 merely acts as a multiplier of transportation rates, it does not take into account the fuel efficiency gains achieved by UP. Fuel usage by UP locomotives was 2% more efficient in 2005 compared to 2004; efficiency increased another 2% in the first quarter of 2006 compared to the first quarter of 2005. UP's 2005 Annual Report at 16; UP Form 8-K, filed with the Securities and Exchange Commission ("SEC") on April 20, 2006. Lastly, UP utilizes an array of other strategies to reduce its exposure to volatility of diesel prices. UP's 2005 Annual Report at 35 ("We may use swaps, collars, futures and/or forward contracts to further mitigate the impact of adverse fuel price changes."); UP's 2003 Annual Report at 16 ("To help reduce the impact of fuel price volatility on earnings...we will continue to adhere to our hedging strategy.").

Over-recovery of fuel costs is suggested by UP's recent financial results, which show that revenues have outpaced fuel cost increases. In the fourth quarter of 2005, UP revenues increased \$404 million compared to the 2004 fourth quarter, but the UP "fuel and utilities" category of operating expenses increased only \$220 million. UP Form 8-K, filed with the SEC on January 19, 2006. Similarly, for the first quarter of 2006, UP's operating revenue was \$558 million higher than the first quarter of 2005, but its "fuel and utilities" expenditures increased only \$153 million. UP Form 8-K, filed with the SEC on April 20, 2006.

This built-in differential is compounded by the fact that UP and BNSF have not rebased the \$1.24 and the \$1.35 thresholds in Item 3380 and Item 690 to account for the fact that

¹⁶ The HDF table of fuel prices is found at http://www.uprr.com/customers/surcharge/surcharge_coal.shtml.

increases in the cost of diesel fuel are eventually reflected in newly established transportation rates. Specifically, the last time the HDF was below \$1.35 was in September, 2002. As UP and BNSF have negotiated or established new transportation rates for CEMEX since September, 2002, such rates have included the current cost of locomotive fuel, as well as that particular movement's share all of UP's or BNSF's current variable and fixed costs. Thus, using the 4Q05 numbers above, a transportation rate provided in 4Q05 should include UP's and BNSF's current cost of fuel. To the extent that UP's or BNSF's actual fuel costs do not subsequently "spike," or fuel cost increases are covered by a rate adjustment provision such as the RCAF, there is no justification for assessing the fuel surcharge multiplier to the transportation rate because the rate would reimburse UP and BNSF for all of the fuel costs it incurs to provide the issue transportation.

UP's and BNSF's fuel surcharges have increased substantially over the past 5 years when calculated as a percentage of revenue. The fuel surcharge has become more of a revenue-producing practice every year since surcharges were first implemented. Moreover, to the extent UP is providing the subject transportation pursuant to common carrier rates established pursuant to Circulars 111, 112, or 113, UP has reserved its right under applicable law "to adjust or cancel rates subject to 20 days' notice for increases." *See e.g.*, UP Circular 112 at 2 and UP Circular 111, Service/Rate Selection: Option 1 at 1.

The BNSF and UP fuel surcharge programs are further flawed on their face because they do not measure actual costs but merely apply a multiplier to the transportation rate. They bear no relation to the amount of fuel used for the movement being assessed the charge. Clearly, if there is no evaluation of the amount of fuel used or the actual cost paid for fuel, then the surcharge is not "used only to recover the increased cost of fuel for the particular movements to which the

surcharge is applied.” Notice at 2. A further illustration of the lack of correlation between cost and recovery is that the fuel surcharge sets a floor whereby if the price of fuel dropped below the minimum threshold, no benefit incurs to the shipper.

This overcompensation is further compounded by the fact that the multiplier is largely independent of the distance of the movement or any other characteristics that affect fuel consumption for a particular movement. While such characteristics are necessarily factored into the transportation rate to some extent, railroad rates are not established solely based on the railroad’s costs. Indeed, in today’s commercial and regulatory atmosphere, railroads rates are established at levels substantially above a railroad’s costs for both captive and non-captive rail shippers. As explained below, the present lack of railroad competition and regulatory relief for high rail rates has contributed to the degree to which railroad fuel surcharges have significantly over-compensated the railroads for spikes in the price of diesel fuel. Railroads keep getting the benefits of the price increase while the shipper bears the burden of the volatile diesel spot market.

Moreover, railroads consume huge quantities of railroad diesel fuel annually and often engage in price hedging activities. Railroads are in a unique position of being able to perform large scale physical hedging because of the substantial amounts of fuel they use. CEMEX believes that the railroads should be allowed to pass through prudently incurred fuel-related expenses to their customers, similar to the manner in which public utilities are able to pass through the actual cost of natural gas and fuel increases, subject to review by their regulators. 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 and reasonable hedging program with both financial and physical hedging.

IV. THE BOARD SHOULD REQUIRE THE SUBMISSION OF REVENUE AND COST DATA JUSTIFYING THE IMPOSITION RAILROAD FUEL SURCHARGES

To the extent the Board does not believe it already receives enough data from the Class I railroads, or has not received enough data from the Class I railroads as a result of this proceeding, to enable the Board to determine whether a particular fuel surcharge provides a railroad with more revenue than it needs to recover the railroad's fuel costs for a particular movement, the STB should adopt procedures to govern the submission of such data. The STB has clear authority to obtain the data it needs under 49 U.S.C. § 721(b).¹⁷ Railroads already provide certain fuel cost data to the STB on a quarterly basis through the RCAF process. 49 U.S.C. § 10708.¹⁸ In addition, the Board also requires railroads to submit certain cost and revenue data under 49 CFR Parts 1200 through 1300. Furthermore, railroads are required to report certain information regarding carrier rates and service terms pursuant to 49 CFR Parts 1300 through 1332. CEMEX asserts that the data requirements should include information on revenues from fuel surcharges under contracts, since in nearly all cases the contract incorporates the public fuel surcharge by reference without any modifications. Thus, CEMEX believes the Board has the requisite power to use existing or add regulations to obtain any additional information needed to substantiate that "railroad fuel surcharges are being set in such a manner as to insure that they are used only to

¹⁷ 49 U.S.C. § 721 (b) (2006). "Inquiries, Reports, and Orders. - The Board may - (1) inquire into and report on the management of the business of carriers providing transportation and services subject to subtitle IV; (2) inquire into and report on the management of the business of a person controlling, controlled by, or under common control with those carriers to the extent that the business of that person is related to the management of the business of that carrier; (3) obtain from those carriers and persons information the Board decides is necessary to carry out subtitle IV; and (4) when necessary to prevent irreparable harm, issue an appropriate order without regard to subchapter II of chapter 5 of title 5."

¹⁸ 49 U.S.C. § 10708 (a) (2006). "Rail cost adjustment factor: (a) The Board shall, as often as practicable, but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Board, with appropriate adjustments to reflect the change in composition of railroad costs, including the quality and mix of material and labor)...."

recover the increased cost of fuel for the particular movements to which the surcharge is applied.”

Notice at 2.

Finally, high fuel surcharges coupled with increasingly poor service has caused public confidence in the rail system to deteriorate. Rail transportation becomes increasingly vital to shippers, particularly coal shippers. Rail service failures and reliability problems have hindered utilities’ coal supplies. A mild winter and utility coal conservation measures averted coal inventory problems thus far. However, rail service needs improvement in order to return coal stockpiles to acceptable levels. One part of restoring public confidence in railroad service and reliability is for the railroads to actively participate with the Board and shippers to alleviate the fuel surcharge discrepancy. Railroads need to provide information to the Board and to the public so shippers can appreciate the actual cost of service.

V. CONCLUSION

CEMEX applauds the Board for taking action on the fuel surcharge issue and holding a public hearing. However, the Board must take definitive steps to rectify the problem following the public hearing. The Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate; (2) find that rail fuel surcharges are unreasonable practices in violation of 49 USC § 10702(2); (3) establish narrow, cost-based standards for recovering actual cost variations of fuel expended for a particular shipper’s transportation that are not adjusted by other means; and (4) require transparency in the submission of revenue and cost data justifying the imposition of railroad fuel surcharges and provide oversight of railroad fuel cost recovery.

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