



Sandra J. Dearden, President

September 28, 2006

Surface Transportation Board
Attn: STB Ex Parte No. 661
1925 K Street, N.W.
Washington, DC 20423-0001

Re: Rail Fuel Surcharges
STB Ex Parte No. 661

Enclosed please find a copy of the Comments on the Board's proposed measures set forth in its Decision of August 3, 2006, submitted by HIGHROAD Consulting, Ltd., which is being filed electronically today.

Sincerely,

A handwritten signature in black ink, appearing to read "Sandra J. Dearden", written in a cursive style.

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Before the
SURFACE TRANSPORTATION BOARD
Washington, D.C. 20423

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RAIL FUEL SURCHARGES	)	STB Ex Parte No. 661
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REPLY OF HIGHROAD CONSULTING, LTD.
TO STB DECISION AND REQUEST FOR COMMENTS,
DATED AUGUST 3, 2006

Sandra J. Dearden
HIGHROAD Consulting, Ltd.
29 S. LaSalle Street, Suite 450
Chicago, IL 60603
(312) 201-0836
Dated: September 28, 2006

I. INTRODUCTION

HIGHROAD Consulting, Ltd. (HIGHROAD) is a transportation and logistics consulting firm with a diverse client base that includes numerous rail shippers as well as some railroads in North America. HIGHROAD is a party of record in this proceeding and hereby submits its Reply to the Board's proposals set forth in its Decision dated August 3, 2006.

The Board, in its Decision, advised they are addressing what they believe is an unreasonable practice of applying what the railroads label a fuel surcharges in a manner that is not limited to recouping increased fuel costs that are not reflected in the base rate, and the Board proposed measures that are designed to preclude such an unreasonable practice. We commend the Board for initiating this rulemaking proceeding and for developing the measures set forth in the Decision.

The intent of the Decision was very clear and requires only minor changes so reporting requirements are not open to misinterpretation. Further, in the Board's endeavor to establish measures for future conduct to address such an unreasonable practice, we petition the Board to include a process for enforcement.

Because we agree with the Board's recommendations, the comments presented herein will focus only on the Board's opinion that the current fuel surcharge programs constitute an unreasonable practice, the need for clarification of the reporting requirements, a request for the Board to develop and establish a process to allow rail customers to seek recourse if the railroads fail to comply with the new guidelines.

II. THIS RULEMAKING PROCEEDING ADDRESSES AN UNREASONABLE PRACTICE OF APPLYING WHAT THE RAILROADS LABEL A FUEL SURCHARGE, IN A MANNER THAT IS NOT LIMITED TO RECOUPING INCREASED FUEL COSTS THAT ARE NOT REFLECTED IN THE BASE RATE.

We agree with the Board's decision that the application of the standard fuel surcharge programs by the railroads constitutes an unreasonable practice. Of significance is the fact that not one of the presenters representing rail customers, that presented testimony at the hearing on May 11, disagreed with the railroads' right to recover extraordinary unanticipated increases in fuel costs. At the hearing, while the rail customers and carriers disagreed on some of the key issues, it appeared that all were willing to focus on the same objective, i.e., to develop a program that adequately compensates the railroads, that will gain acceptance by the customers. However, while the railroads said they planned to learn from the hearing, they have not followed through with initiatives to adjust their fuel surcharge programs since the hearing.

The apparent disconnect between the carriers and shippers is not a problem that suddenly developed – this has been building for some time. There is adequate evidence that supports the Board's decision that the railroads have performed an *unreasonable practice*, and the railroads were aware that they were over-recovering fuel costs from some customers. Thus, the fuel surcharge programs and over-recovery were not inadvertent, but part of the railroads' strategic plans.

When preparing for the hearing on May 11, HIGHROAD developed cost evidence for four shippers that revealed the fuel surcharges were four to five times higher than the total fuel costs for the lanes studied.¹ Even though HIGHROAD has personnel on staff with experience in rail costing and working with the R-1 data, because of the importance of this proceeding, the cost evidence was developed by two experts who are transportation economists and who, previously, were on staff at the STB. The methodology for calculating the fuel costs was presented in

¹ See testimony of Chevron Oronite, Corn Products International, Inc.; Darling International, Inc.; and Diversified CPC International, Inc.

HIGHROAD's statement², and in statements filed by our clients, and we are confident in the accuracy of the cost evidence as presented.

In May, 2003, HIGHROAD released a Rail Fuel Impact Study that revealed the fuel surcharges assessed at that time were not supported by changes in fuel costs as reported by the railroads in reports to the governing agencies. That study was subsequently featured in an article in *Traffic World* magazine.³ Since then, numerous articles have appeared in various trade publications, questioning the fairness of the fuel surcharges.

While some of the railroads have failed to respond to on-going criticism, a few have attempted to modify their fuel surcharge programs with the objective to develop programs that are "fair". Canadian National (CN) and Canadian Pacific (CP) modified their programs which reduced surcharge levels applied by those railroads. Cost analyses need to be performed to determine if the CN and CP programs fully addressed the unfairness of the surcharge programs. However, since both are based on a percentage of the rates, we believe it likely that inequities still exist.

Further, Burlington Northern Santa Fe attempted to move in the right direction by establishing a mileage based program, although it was rejected by some shippers on the basis it required further refinement.

Interested parties, including non-financial executives, can develop meaningful rail cost information, including fuel costs, by reviewing the railroads' annual reports. While it may present a somewhat simplified picture, the information reported as public information, points to the fact that the railroads were very aware that they were over-recovering from some customers.

Summarized below are the average total fuel costs per car for each of the Class I railroads, as reported in their 2005 Annual Reports. It is interesting to note

² See HIGHROAD testimony, pp. 3 – 4.

³ John Gallagher. "Following the Competition". *Traffic World*, July 28, 2003, pp. 28 - 29.

that all though the index used by the eastern carriers produces higher fuel surcharges versus the index used by the western carriers, the eastern carriers' fuel costs are lower.

CLASS I RAILROADS
2005 AVERAGE TOTAL FUEL COSTS PER CAR

<u>Railroad</u>	<u>Total Average Fuel Costs P/C</u>
BNSF	\$195.43
CN	\$149.76
CP	\$219.73
CSX	\$151.06
KCS	\$230.63 ⁴
NS	\$ 93.46
UP	\$268.44

Also, shown below is an example of how you can use information published in the annual reports to monitor railroad fuel costs and surcharge revenues. The table below shows additional revenue and cost information reported by BNSF in their 2005 Annual Report, comparing revenue and cost information to the previous two years. The intent is not to single out BNSF, but to simply present an example of information that is public information, that confirms the fact that the railroads understand their costs, and that this railroad over-recovered fuel cost increases, even if you only use year-over-year comparisons.⁵ Similar information can also be developed from the Annual Reports of other Class I railroads.

⁴ U. S. Operating Expenses.

⁵ The need to define appropriate base year(s) for comparison is discussed in Part II herein.

EXAMPLE

	<u>2003</u>	<u>2004</u>	<u>2005</u>
(1) Average Fuel Cost Per Car	\$126.42	\$140.00	\$195.43
(2) Average Fuel Cost Increase Per Car		\$ 13.58	\$ 55.43
(3) Average Fuel S/C Revenue Per Car	\$ 26.20	\$ 51.49	\$124.63
(4) Change in Average Fuel Surcharge Per Car vs. Previous Year		\$ 25.29	\$ 73.14
(5) Fuel Surcharge Overcharge Per Car vs. Previous Year (Line 4 minus Line 2)		\$ 11.71	\$ 17.71
(6) Annual Carloads	(000's) 8,646	(000's) 9,536	(000's) 10,024
Annual Over-Recovery (Line 5 multiplied by Line 6)		(Million) \$111.7	(Million) \$177.5

We support the Board's proposal, "to require that fuel surcharges be tied not to the level of the base rate, but to the attributes of a movement that directly affect the amount of fuel consumed." While the current programs are easy for the railroads to administer, they produce surcharges that over-recover fuel costs. The railroads have the resources and sophistication to develop models for calculation of surcharges. The surcharges should be calculated based on mileage and weight of shipment, and different models could be used for different shipment characteristics or business segments, such as unit train shipments, shipments handled in special train service, etc.

III. THE FUEL SURCHARGE PROGRAMS SHOULD INCLUDE A MECHANISM SO CALCULATION OF INCREASES OR DECREASES IN FUEL COSTS CAN VARY, BASED ON DIFFERENT START DATES.

The index proposed by the Board is a good index that should be acceptable to the carriers and the shippers, and we assume the railroads will respond to the

Board's request to develop fuel surcharge programs that are based on miles. Therefore, the base surcharge amount is of utmost concern and will impact on the fairness of surcharges for individual movements.

The railroads initiated the current fuel surcharge programs in October, 2002, that were designed to recover cost increases that had occurred since 2001. A surcharge in October, 2002 was 1% - 2%; the railroads have been using the same indexes since and the surcharges have increased to levels as high as 20.8%. During this same time period, rates have been increased, and new rates have been negotiated, including rates for new moves. (Because the surcharges are based on a percentage of the rates, rate increases also result in increased fuel surcharge revenues for the railroads.)

Earlier this year, we negotiated rates for a client that is constructing a new manufacturing facility that is scheduled to open in June, 2007. In the negotiations, the railroad marketing personnel maintained a firm position on the railroad's policy to apply its standard fuel surcharge program. Fuel surcharges should reflect the change in fuel prices from an established starting point. If there have been no prior movements, prior changes in fuel prices are not relevant, so the shippers and carriers should be able to agree on a starting date and base surcharge, and the fuel surcharges should reflect changes in fuel prices from that point forward.

IV. THE REPORTING REQUIREMENTS PROPOSED BY THE BOARD REQUIRES CLARIFICATION.

The Monthly Report of Fuel Cost, Consumption and Fuel Surcharge Revenues proposed by the Board should give the shippers adequate information to better monitor the railroads' fuel costs and fuel surcharge practices. However, the form does not specify what is to be used to measure the increased or decreased fuel costs in Line 2, Increased or Decreased Cost of Fuel. Are the railroads to report increased or decreased costs of fuel since 2001, 2002, the previous month, or some other

date? The base starting date for calculating changes in fuel costs needs to be defined.

V. THE STB SHOULD ESTABLISH A PROCESS TO GIVE SHIPPERS PROTECTION FROM UNREASONABLE PRACTICES THAT MAY OCCUR IN THE FUTURE.

We request that the Board establish a procedure that will give shippers recourse if railroad(s) fail to comply with the new rules, and the right to challenge surcharges that exceed the incremental changes in fuel costs for the movements to which the surcharges are applied. The process should be simple and user friendly, so it is affordable for all rail customers, including small shippers.

VI. SUMMARY

We agree with the Board's position that the current railroad fuel surcharge programs constitute an unreasonable practice.

There is sufficient evidence that the railroads have been aware that they were over-recovering fuel expenses from some of their customers. Further, we concur with the Board's recommendation that surcharge programs be developed that are based on mileage and weight of shipments.

Fuel surcharges should reflect changes in fuel prices from an established starting point.

Fuel cost increases that occurred prior to the effective date of a new rate are not relevant. Further, if there have been no prior movements, prior changes in fuel prices are also not relevant. Shippers and carriers should be able to agree on a base surcharge and the fuel surcharges should reflect changes in fuel prices from that point forward.

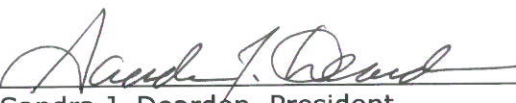
The base date for calculating changes in fuel costs needs to be defined.

The reporting requirements proposed by the STB require clarification (Monthly Report of Fuel Cost, Consumption and Fuel Surcharge Revenue). The base date

needs to be defined for the railroads to report changes in the cost of fuel (refer to Line 2, Increased or Decreased Cost of Fuel).

HIGHROAD appreciates the opportunity to present our views to the Board, and we urge the Board to establish the guidelines, enforceable on complaint, to require that fuel surcharges be limited to those amounts necessary for railroads to recover potential fuel cost increases.

Respectfully submitted,

By: 
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Dated: September 28, 2006