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October 2, 2006

By Electronic Filing

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

Re: Ex Parte No. 661, *Rail Fuel Surcharges*

Dear Mr. Williams:

Pursuant to the Board's decision in the above-entitled proceeding, served August 3, 2006, Canadian National Railway Company ("CN") submits for the record the enclosed comments.

Sincerely,

A handwritten signature in black ink that reads "Theodore K. Kalick". The signature is written in a cursive, slightly slanted style.

Theodore K. Kalick

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 661

RAIL FUEL SURCHARGES

**COMMENTS OF
CANADIAN NATIONAL RAILWAY COMPANY**

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Following its consideration of written statements and testimony at a public hearing on May 11, 2006, the STB has requested comments in this proceeding on a series of proposed measures regarding railroad fuel-surcharge practices. *STB Decision*, August 3, 2006. CN submits these comments in response.¹

The Board proposes that carriers:

- compute surcharges that are not tied to the level of the base rates, but instead more closely to movement attributes that more directly affect the amount of fuel consumed: either mileage alone or, preferably, weight and mileage. Railroads would have discretion to devise an alternative methodology, so long as it would have a reasonable nexus to the fuel consumption for the movement involved;
- use the Energy Information Administration (EIA) U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon) as the single, uniform index for measuring changes in fuel costs;
- eliminate “double-dipping” -- charging for the same increases in fuel costs for the same shipment both through a fuel surcharge and through application of a rate index such as the STB’s Railroad Cost Adjustment Factor (RCAF) – by subtracting out any fuel component from such an index; and

¹ CN also joins in the comments filed on behalf of the railroad industry by the Association of American Railroads.

- file monthly reports with the Board disclosing actual fuel costs, total fuel consumption, total fuel surcharge revenues, and the amount of fuel surcharge revenues shared with short-line connections.

CN appreciates the concerns expressed by various parties that have led to the Board's proposed measures, several of which we believe to be useful. CN, however, would caution the STB in moving ahead on the most substantive aspect. No particular fuel-surcharge approach for recovering the increases in fuel expenses that carriers experience in today's volatile fuel markets is necessarily optimal. Despite claimed deficiencies, CN respectfully submits that so long as it does not over-recover a carrier's overall increase in fuel expense, a properly applied revenue-based surcharge is a fair and reasonable approach that satisfies several important customer and carrier objectives. While the STB's proposal that carriers establish mileage (or weight-and-mileage-based) surcharges might appear more equitable, such surcharges will have imperfections of their own. They will also be more complex to implement and administer, and produce a much greater risk of customer-carrier disputes -- and greater demand for the STB to intervene and referee them -- that is likely to serve no one well.

Should the STB eventually conclude that carriers should establish surcharges more closely tied to a movement's fuel consumption, however, CN requests that it afford carriers and customers sufficient time to comply, given the time and costs that will be required to do so efficiently and fairly. CN would also urge the Board to indicate that there is not necessarily a "one-size-fits-all" solution to such a directive, and that the agency will leave to a case-by-case assessment the reasonableness of responsive surcharge programs that may subsequently come under its review.

CN'S FUEL SURCHARGE

The Board commenced this proceeding to address concerns that carrier fuel surcharges had been “designed to recover amounts over and above increased fuel costs.” *STB Decision*, March 14, 2006, at 1. As CN indicated in its April 27th written statement and its testimony at the May 11th hearing, CN established its fuel surcharge solely to recover increases in fuel expense that the Company incurs – not to increase profits – and in the five years since its inception, it is only recently that CN’s surcharge has begun to recover fully its increased fuel expense.

Since May 2001, when CN first initiated its fuel surcharge, we have been guided by certain basic principles:

- The fuel surcharge must be reasonable.
- It must be clearly understood and simple to apply.
- It must be applied uniformly.

While acknowledging CN’s need for a mechanism to recover its increased fuel expenses, our customers expect CN’s fuel surcharge to be fair, simple to understand, and workable, one that will minimize tracking and billing issues.² In turn, CN’s has sought to apply the surcharge equally to all of our customers and thereby deliver the lowest surcharge needed to recover the increased fuel expenses that we incur. As a result of

² Application of the fuel surcharge is triggered when the price of West Texas Intermediate (WTI) crude oil is \$25 per barrel and above, with CN’s fuel costs reflective of WTI crude prices below that level factored into CN’s base rates. The surcharge reflects the relationship of CN’s total fuel expense to total revenues, and in any monthly period is intended to recover CN’s increased fuel expenses from across our customer base after WTI crude prices reach the \$25 per barrel threshold. Based on that relationship and for ease of application, for each additional \$1 per barrel increase in WTI crude above \$25, CN’s fuel surcharge increases by 0.25%.

expiring confidential contracts and consistent efforts with our customers, in April 2005 CN adopted CN Tariff 7401 that reduced surcharge rates approximately 25% below those in our initial surcharge tariff, CN Tariff 7400, and then an additional 15% in a modification to CN Tariff 7401 in October 2005.³ By adhering to these principles, CN has established a simple percentage-of-revenue surcharge that is approaching universal application and that has consistently resulted in the lowest fuel surcharge rates in the industry. CN will continue to review the conditions underlying its surcharge and adjust it further, as necessary.

THE STB'S PROPOSALS

CN acknowledges the confidence and trust that could be generated through steps to improve the transparency, consistency, and fairness of carrier fuel surcharges. Accordingly, CN does not object to the STB's proposed measures that would require uniform reliance on the EIA "On-Highway Diesel" (OHD) index to measure changes in fuel expense; carrier reporting; and the removal of fuel components from the RCAF or other indices that could allow for the double recovery of increased fuel expenses (an issue which CN has already addressed).

CN also understands the rationale behind the Board's proposal that carriers shift to fuel surcharges more closely linked to a movement's actual fuel consumption -- that revenue-based surcharges do not distribute fuel cost recovery precisely due to differences in fuel cost per dollar of revenue for differently rated traffic. CN submits, however, that the mileage (or weight-and-mileage-based) surcharges that the STB suggests, while

³ A fuel surcharge comparison of the revised CN Tariff 7401 (October 2005) with surcharges in CN Tariff 7400 (May 2001) and the initial version of CN Tariff 7401 (April 2005), along with a copy of CN Tariff 7401 and the schedule outlining the application of surcharge amounts, were provided as an Attachment to CN's April 27 Statement.

theoretically more attractive, will be no more precise. This is so because fuel cost per car-mile for same-distance movements can vary significantly depending, in addition to weight, on speed, the intensity of local switching, empty return ratio, track conditions, geography, and overall operating conditions.

Moreover, these surcharges will be more complex to implement and administer in ways that are likely to defeat any perceived benefits. In contrast to revenue-based surcharges, they will present a much greater potential for billing disputes, beginning with the methodologies and systems a carrier chooses for calculating, tracking, and administering applicable mileage⁴ that will be complicated by the need to reconcile with the choices of its interline partners, and by changes to well-established industry systems for managing interline traffic that would be required to accommodate mileage-based surcharges across the rail network. A commonly accepted nationwide rail mileage index does not exist, and neither the Interline Settlement System (ISS) nor the Electronic Data Interchange (EDI) can currently process interline settlements incorporating fuel surcharges stated on a mileage basis.

Effecting the changes to industry systems necessary to accommodate mileage surcharges for interline traffic, as well as changes CN and its customers will require to their own respective accounting and invoicing systems, will take considerable time and expense. The ISS is managed by Railinc and overseen by AAR's Network Efficiency Management Committee (NEMC), and a project of this magnitude, even if normal NEMC procedures for considering changes to the ISS could be accelerated, would likely

⁴ Disputes could arise over innumerable issues in this regard ranging, for example, from choices over appropriate mileage and routing tables to accounting for changed mileage due to the diversion or re-consignment of traffic that occurs daily.

take up to a year or more. For EDI, the rail industry has been placed on a two-year cycle for proposed changes, and proposals submitted now, if ultimately determined to be workable, are not likely be implemented until at least 2008. Adjusting CN's own accounting and billing systems to accommodate a mileage surcharge and minimize invoicing errors will also require significant time and expense, with similar burdens falling on each of our customers, large and small, some of which could disproportionately impact smaller rail users.

For these reasons, CN continues to seriously question whether any minor improvement in equity that might be gained through mileage-based fuel surcharges is worth the substantial complexity, time and cost required to implement and administer them, or the Board's inevitable intervention to umpire the myriad of disputes they are likely to produce. This is especially so when a sensible and fairly applied revenue-based surcharge such as CN's can achieve the same goal -- an equitable recovery of a carrier's overall increase in fuel expense -- more simply and effectively.

Thus, before embarking on a more intrusive and unpredictable regulatory direction, CN respectfully submits that the STB and the public would be better served if the Board were to proceed only with the more informational and trust-building aspects of its proposals.⁵ Such a step -- especially now as fuel prices are moderating and surcharge rates are starting to decline -- would enable the Board and the public to gain the transparency and consistency needed to better assess the reasonableness of current carrier

⁵ Once the Board determines its final reporting requirements, CN will develop the systems necessary to segregate and produce the requested data for our U.S. operations and provide that information to the agency.

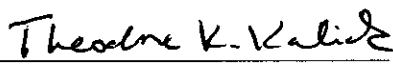
surcharge practices, and, in a less urgent atmosphere, examine more closely the implementation and administration issues surrounding mileage surcharges.

Should the STB determine instead to move ahead as proposed, then for the reasons outlined, the agency needs to provide carriers and shippers sufficient time to comply. It is also important for the Board to reiterate that carriers would have the discretion in the first instance to devise a responsive surcharge methodology, so long as it would provide a reasonable nexus to the fuel consumption for involved movements. *STB Decision*, August 3, 2006, at 5. There may be several reasonable approaches to establishing that nexus, and given the substantive and practical complexities of this matter, we urge the STB to be careful not to pre-judge any approach in advance.

Respectfully submitted,

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