

**BEFORE THE  
SURFACE TRANSPORTATION BOARD  
WASHINGTON, D.C.**

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**STB EX PARTE NO. 661**

**RAIL FUEL SURCHARGES**

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**COMMENT OF THE AMERICAN SHORT LINE AND REGIONAL  
RAILROAD ASSOCIATION**

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Keith T. Borman  
Vice President & General Counsel  
American Short Line and Regional Railroad Association  
Suite 7020  
50 F Street N.W.  
Washington, D.C. 20001-1564  
Telephone 202-628-4500  
Fax: 202-628-6430  
Email: kborman@aslrta.org

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The American Short Line and Regional Railroad Association (“ASLRRA”) respectfully submits its Comments concerning the Board’s proposed rules concerning railroad fuel surcharges. These comments are submitted in response to the August 3, 2006 Decision by the Board soliciting public comment on the proposed rules.<sup>1</sup>

**Statement of Interest**

ASLRRA represents approximately 425 class II and class III railroads in the United States, Canada and Mexico as well as numerous suppliers and contractors to the short line and regional railroad industry. ASLRRA thanks the Surface Transportation Board for inviting the comments of interested parties.

**Comments**

It is critical to the understanding of how a mileage-based fuel surcharge program would affect short lines to recognize that across the various carrier classifications discussed in these Comments, short lines virtually *always* collect a division of the revenues for a movement which are proportionately larger – and often *much larger* – than

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<sup>1</sup> 71 Fed. Reg. 45900-01 (Aug. 10, 2006).

their proportion of the route miles on the move. For over 100 years and continuing today, the prevailing division of revenue earned by an originating or terminating rail carrier, many of whom are short lines, is 15 % to 20% of the total freight charges, which reflects the greater amount of work, including switching, setting out, delivery, pick-up blocking, etc., performed at origin and destination and the fuel consumed in so doing, while the short lines' percentage of total rail haul miles is 5% to 8%. Those short lines today receive 15% to 20% of the fuel surcharge. With a mileage-based system, they would receive 5% to 8%, a devastating loss.

These proportionately higher costs are due to several factors: short line railroads are typically the gathering and distributing lines with the shortest portion of the low cost 'long haul' and usually undertake a relatively high amount of switching activity. Their costs per unit of activity are correspondingly higher and are spread over fewer route miles. Similarly, they are captive to local geographic conditions, such as mountainous terrain, which cannot be offset as they can be in other regions of huge Class I route systems. Their average speeds are slower with many more stops and starts than the typical Class I movements entail, and they typically operate older and less energy-efficient Class I cast-off locomotives. They also typically operate much shorter trains with higher per-car costs and they certainly do not enjoy the purchasing power the Class I railroads command when negotiating fuel prices with suppliers.

All of these attributes lead to much higher fuel and other costs per unit of activity than a strict mileage-based formula based on Class I economic input can accommodate.

The current division of rates between Class I and short line railroads recognizes and values all of these factors in the marketplace. Division of fuel surcharges based on the proportion of revenues collected for an overall routing is a more accurate reflection of the real cost of fuel to short lines than a simplistic mileage-based formula. For these reasons, the proposed substitution of a Board-mandated Class I mileage or ton-mileage fuel surcharge system would have a devastating effect on the Class II and III interline carriers, particularly if they faced the double impact of an overall reduction in fuel surcharge collected by the Class I railroad compounded by a smaller division of the reduced surcharge based on their proportionately smaller share of route miles.

One reason a seemingly simple one-size-fits-all mileage or ton-mileage fuel surcharge directive would not work efficiently or fairly for short lines is because its effects would be inconsistent depending upon the classification of the short line (handling line, junction settlement, interline ISS or switch carrier) and the nature of the particular Class I fuel surcharge program(s) under which the short lines operate.<sup>2</sup> The multiplicity of individual factors involved make the fuel surcharge relationships much like an enormously complicated real life “Rubik’s Cube” in which an adjustment to satisfy one particular constituency will inevitably throw out of adjustment other carefully balanced interests in ways that are both unforeseeable and unfixable. An examination of how current fuel surcharge practices differ among carrier classifications will illustrate the problem.

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<sup>2</sup> Some railroads operate under more than one Class I fuel surcharge framework.

Among all categories of short line carriers the largest number act as “handling lines” for their Class I connections. Many of them came into existence as spin-offs from their Class I partners and handle business over former Class I lines for a fixed “handling” fee per car negotiated with the Class I railroads at the time they were spun-off. For the most part, handling line agreements did not contain any provisions for fuel cost adjustments.

ASLRRA made it a high priority to bring this inequity to the attention of Class I railroad management, and at this time all Class I railroads have developed their own programs to share some part of their fuel surcharges with their handling lines. In some cases the handling lines receive a fixed fee per car, in others it is calculated as a percentage of the per car handling fee. Generally the Class I handling line fuel surcharge sharing programs are based on the total fuel surcharge collected by the Class I railroad on traffic interchanged with all of the Class I railroad’s handling lines. Of particular note in the current proceeding, if the handling line fee paid to the short line happens to contain a cost-adjustment provision indexed to the STB’s RCAF(U) (or similar formulae that include a fuel cost component), the fuel portion is subtracted from the index before adding back the fuel surcharge payment to avoid short line “double dipping”. While ASLRRA has no independent data, one holding company operating multiple handling line carriers estimates that in the second quarter of 2006, the amount of fuel surcharge shared by the Class I carriers with its handling lines amounted to approximately six percent of the handling fee paid to those short lines, or less than one-half of the average Class I surcharge of sixteen percent during the same period.

On an industry-wide basis it is clear that a fuel surcharge of six percent only recently shared with handling lines is unlikely to make whole at any point in the near future the carriers that did not participate in any fuel surcharges in the preceding years of fuel price increases. Even worse, it is likely that if the current programs are eliminated by regulatory fiat and replaced with a mileage or ton-mileage mandated program, short line “handling line” carriers will stand to lose most or all of the modest participation in the Class I fuel surcharges they worked so hard to achieve. They will also lose the chance to recoup over time the losses of the earlier years when they could not participate in the Class I surcharge programs.

This outcome is likely for two reasons. First, if a mileage-based system is imposed upon the Class I carriers, they may move away from sharing their fuel surcharges with short lines on the basis of a percentage of handling fee and instead impose their own mileage-based allocation. Because of the very short distances handling carriers typically move traffic, this approach would result in an inevitable and substantial erosion of handling line fees. Second, to the extent that a mileage-based program reduces Class I revenues, it would encourage Class I railroads to substantially or completely eliminate their fuel surcharge programs in favor of simply raising their haulage rates, eliminating all the fuel surcharge sharing programs the handling lines have finally achieved and leaving the handling lines with only their old fixed per car handling fees. It took years for ASLRRRA and the handling lines to gain participation in the current Class I fuel surcharge programs, and it is pure speculation to guess how long – if ever - it would

take handling lines to negotiate new fixed handling line fees adjusted to replace lost fuel surcharge revenue, especially if the Class I revenues and profits are adversely impacted by the change.

Junction settlement carriers are in a similar position. They differ from handling line carriers because their stations are identified to customers in traffic routings, but they too must negotiate with the Class I's for their portion of the revenues for the traffic movement, all of which is billed and collected from the customer by the Class I carrier. The Class I railroads typically collect fuel surcharges based on the entire revenue from the through movement on all lines. Junction settlement carriers, while they may not operate on a fixed handling fee as handling lines, nevertheless must still negotiate on a system-wide basis whatever portion of the fuel surcharges they can convince the Class I to share. One junction settlement carrier operating in the south central US reports that its share of fuel surcharges recently amounted to around 20% of its base revenue for a particular move, which is a level comparable to that charged by a Class I. To the extent that a mileage-based fuel surcharge formula is mandated and results in a decrease in fuel surcharges to junction settlement carriers, a likely outcome as discussed below, the impact on these carriers would be severe.

In the event that a mandated mileage-based fuel surcharge program either reduces Class I revenues, as it likely would, or pushes Class I carriers away from a fuel surcharge program and toward "rebasing" their own shipping rates to customers to eliminate altogether fuel surcharges, the junction settlement carriers will likely sustain

revenue reductions. If the Class I carriers choose to abandon mandated mileage-based fuel surcharges in favor of rebasing, they will have a disincentive to pass along the increase in base rates to the short line junction settlement carriers because, if base rates begin to fall, they cannot unilaterally and automatically reduce the portion of the revenue paid to the junction settlement carriers as they would with a fuel surcharge; they will have to negotiate with the junction settlement carrier each time a reduction is necessary. Thus, Class I's are more likely to embrace "rebasing" their rates and at the same time, less likely to pass that substitution for the fuel surcharge along to their junction settlement connections. If the Class I carriers go forward with a mileage-based fuel surcharge, it is likely that they will impose a similar structure on their junction settlement carriers. Even if a mileage-based program does not result in reduced fuel surcharge revenues to the Class I carriers, they are likely to impose a similar mileage-based division of fuel surcharges on junction settlement carriers, and the inevitable result will be a significant reduction in revenue to the junction settlement carriers because, as discussed more fully above, the short line proportion of through rates is almost always significantly larger than the short line proportion of route miles on a movement.

While interline "ISS" carriers set their own rates, most fuel surcharges are collected by the billing carrier (usually the originating railroad) and are typically divided according to the division of the freight revenue for the entire movement each carrier receives. Thus, interline carriers, although technically able to set their own fuel surcharge rates have generally followed what could be characterized as the industry practice of participating in the class I surcharge programs.

Finally, switch carriers operate under an entirely different paradigm. To this day, most do not participate in Class I fuel surcharge programs. They are still defining how they can recoup the higher cost of fuel their operations have sustained over the last few years. Typically they are compensated like handling lines, on a fixed fee per switch basis, and anecdotally ASLRRRA understands that in a few cases those fees have been adjusted in lieu of a formal fuel surcharge sharing program. Despite these adjustments, a mandated mileage-based program would provide no relief to switch carriers. In fact, it would permanently exclude them from ever recovering their increased fuel costs. Because of their stop and go, push and pull operations, they consume fuel at a much higher rate than “hook and haul” Class I railroads or even over-the-road short lines. Yet their route miles of travel are virtually non-existent, as would be the revenue they would receive from a mileage-based surcharge. While the optimum arrangement for sharing or recouping increased fuel costs for switch carriers is still being defined by the marketplace, the imposition of the Board’s proposed mileage-based program, if implemented by Class I railroads at the switch carrier level, would be harmful. Thus, ASLRRRA strongly urges the Board to allow the many individual circumstances of the marketplace to resolve the switch carrier fuel surcharge issue.

Many short line and regional railroads have only recently begun to participate broadly in the Class I fuel surcharge programs, although some have received payments as at least as early as 2004. Additionally, one Class I railroad only partially shares with its short lines connections the surcharges for increased fuel costs on their portion of freight

movements. A number of short lines, particularly switch carriers, still do not receive any fuel surcharge revenues. As a result, most short lines have fallen far short of recouping their increased fuel costs of the last few years and only now are seeing some partial relief. The effect of the Board's proposed mileage and ton-mileage rules subject of this proceeding would virtually cut off any chance that many short lines will be able to collect the full amount of the fuel price increases they have sustained. In most cases the loss of revenue would be severe, and in some instances it would be devastating. To avoid this unintended consequence the many individual decisions of the commercial marketplace should be allowed to determine the most economically efficient allocation of the increased cost of fuel among rail transportation consumers and providers.

ASLRRA believes that the Board's proposed reporting requirement could result in needless additional costs to the railroad industry as a whole, further reducing the net offset of higher fuel costs recouped through fuel surcharges. Short line holding company financial experts have advised ASLRRA that it is unlikely that a mileage-based system could be accommodated in the existing railroad industry revenue accounting Electronic Data Interchange (EDI) framework. Costs to re-make the EDI system would be significant and would affect interline short lines even if they are not directly affected by the proposed rules. In addition, if either the Class I railroads or the Board begin to require short lines to provide the kind of monthly financial reporting described in the proposed rules, the costs to gather, maintain electronically and report such data would raise expenses for the short line industry, which already operates on much thinner

margins (higher operating ratios) than the Class I railroads. Some smaller operations would simply not be able to comply at all.

ASLRRA understands the Board's desire to bring transparency to the realm of fuel surcharges. However, the apparently simple adjustment proposed by the Board to the complex Rubik's Cube of fuel surcharge programs developed by the marketplace will have significant adverse consequences to the parts of the Cube that are the short line railroads. Indeed, one surely unintended consequence will be to *increase* the proportion of the collected fuel surcharges the Class I railroads keep and decrease the short line proportion, *even if* the Class I's do no more than impose the same mileage-based system on their short line connections that the Board would require of them, because in every case the short line proportion of miles is *always* significantly less than the short line proportion of revenue on a through move.

ASLRRA urges the Board not to cause inadvertent harm to the gathering and distribution arm of the rail industry by imposing a mandated mileage-based fuel surcharge program in place of the marketplace's solutions to the rising costs of fuel. Aside from the harm inflicted on the short line industry and the additional costs to the entire rail industry, at the end of the day the shipping public will see no benefit. In any economic system the cost of the energy to produce a product or service is ultimately passed on to the consumer; otherwise the product (or service) will not continue to be offered. The marketplace will determine the cost of rail transportation with or without a fuel surcharge. Further, the proposed rules will not create any offsetting long or short

term financial benefit to shippers. The only benefit to shippers of the STB proposal will be a Pyrrhic victory of potentially achieving short-term transparency until the market transforms increased fuel surcharges into increases in base shipping rates. In effect, the long term impact of the STB proposal would be a change in nomenclature without any substantive economic benefit to shippers.

ASLRRA believes that such an ephemeral benefit is not worth the harm across the board to the financial strength of the relatively fragile short line industry that the proposed mandated fuel surcharge program will inflict. If the Board really believes that the marketplace cannot fairly and efficiently deal with the issue of increased fuel costs in the rail transportation industry – a view absolutely not shared by the ASLRRA – then ASLRRA respectfully urges the Board to put its fuel surcharge proposal on hold and to undertake a study to observe how fuel surcharges work over at least a complete cycle of rising *and declining* fuel prices. The Board should also gather in depth data on how fuel surcharges affect the various components of the short line industry before adopting a regulatory solution to the problem of volatile fuel prices. In any event, whether the Board decides to allow the marketplace to determine how fuel surcharges are assessed, to defer action pending further analysis of its effect on short lines, or to impose a regulatory scheme, ASLRRA urges the Board to consider carefully the impact of its decisions on the short line and regional railroad industry.

Respectfully submitted,

American Short Line and Regional Railroad Association

*Keith T. Borman*

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By: Keith T. Borman

Vice President & General Counsel  
American Short Line and Regional Railroad Association  
Suite 7020  
50 F Street N.W.  
Washington, D.C. 20001-1564  
Telephone 202-628-4500  
Fax: 202-628-6430  
Email: kborman@aslrta.org

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