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October 2, 2006

VIA E-FILING

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

Re: STB Ex Parte No. 661
Rail Fuel Surcharges

Dear Secretary Williams:

Pursuant to the Surface Transportation Board's decision issued on August 3, 2006 in the above captioned proceeding, enclosed are an original and eleven copies of the Comments Of The Kansas City Southern Railway Company ("KCSR") to be filed in the above captioned matter. If there are any questions concerning this filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller.com.

Sincerely,



William A. Mullins

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 661

RAIL FUEL SURCHARGES

**COMMENTS OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY**

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Dated: October 2, 2006

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 661

RAIL FUEL SURCHARGES

**COMMENTS OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY**

On August 3, 2006, the Surface Transportation Board ("STB" or "Board") issued a decision in which the Board proposed to adopt a series of policies and procedures regarding the means and methods by which railroads impose fuel surcharges on their shipments. The STB has proposed four main issues for consideration. To summarize, these four issues are:

1. Linkage Requirement – The STB has proposed that fuel surcharges be tied not to the level of the base rate but to those attributes of a movement that more directly reflect the amount of fuel consumed: either mileage alone, or preferably, weight and mileage. The decision states that railroads are free to adopt their own methodologies, but that those methodologies must have a reasonable nexus to the fuel consumption for the particular movement involved.
2. Double Dipping – The STB is proposing to prohibit railroads from charging for the same increases in fuel costs for the same shipment by imposing both a fuel surcharge and a rate escalator that is based on an index, such as the Board's Railroad Cost Adjustment Factor ("RCAF") without first subtracting out any fuel cost component from that index.
3. The Board has requested the railroads to adopt a "single, uniform index for measuring increases in the fuel costs" and has proposed the use of the Energy Information Administration's U.S. No. 2 Diesel Retail Sales by All Sellers (cents per gallon), but other indexes, such as the West Texas Intermediate (WTI) Crude Oil index, could be used as well as long as the railroads agree to one index.
4. The Board has requested the railroads to provide a monthly report showing "actual fuel costs, total fuel consumption, and total fuel surcharge revenues." In the appendix of the August 3rd decision, the Board has proposed a certain format and form for such reporting.

The Kansas City Southern Railway Company ("KCSR") is pleased to provide these comments in response to these four basic proposals. KCSR wishes to comply with the spirit of the Board's

proposals; yet, KCSR remains concerned that some of the proposals are burdensome and unworkable, especially for carriers like KCSR who have a significant amount of joint-line and cross-border traffic.

I. KCSR'S EXISTING FUEL SURCHARGE PROGRAM

The Board's proposals rest on various assumptions and assertions regarding the railroads' current fuel surcharge practices, key among which is that railroads currently impose fuel surcharges based upon a percentage of the overall existing base rate. The Board has declared such fuel surcharge programs an unreasonable practice. While KCSR understands the Board's concerns regarding the use of the base rate and the application of fuel percentage index to that base rate to calculate the appropriate fuel surcharge, KCSR does not believe that its fuel surcharge program has in fact been unreasonable or that the Board has a sufficient basis of fact or analysis to so declare.

KCSR's fuel surcharge program was implemented in April 2003. As fuel is KCSR's second largest cost component, trailing only employee compensation and benefit costs,¹ changes in the cost of fuel threatened to have a significant adverse impact on KCSR's earnings and cash flow absent imposition of a surcharge to account for increasing and fluctuating fuel prices. As KCSR was already revenue inadequate, it was imperative that KCSR find a method by which the rapidly escalating fuel costs could be recovered. To recover these rapidly rising fuel costs, KCSR was forced to institute a fuel surcharge program.

KCSR's fuel surcharge program is based upon the average monthly price of West Texas Intermediate ("WTI") Crude Oil as published daily in The Wall Street Journal. Line haul freight charges are adjusted 0.4% for every \$1 that average monthly price exceeds \$23 per barrel in the

¹ Prior to the dramatic increases in fuel prices and the implementation of the fuel surcharge program, fuel was KCSR's fourth largest cost component.

second calendar month prior to the month the fuel surcharge is applied. For example, the surcharge based on the WTI average price for March was applied May 1. The average WTI price for March 2006 was \$62.90, so that the fuel surcharge beginning May 1 was 16% of the line haul charge. This program is contained within KCSR's general rules tariff KCS-9011-G, which was effective April 11, 2006, and applies to a broad range of KCSR traffic.

KCSR does not discriminate vis-à-vis particular shippers or different commodity groups in applying its surcharge. However, a large portion of KCSR traffic is interlined with other carriers. Often, the originating carrier's surcharge (or that of whichever carrier negotiated rates to obtain the shipper's business) governs interline movements. Therefore, traffic moving on KCSR that is interlined with other carriers often is not surcharged under KCSR's surcharge tariff.

KCSR believes that its fuel surcharge is a fair and easily understood² means for KCSR to recover its fuel cost increases without imposing unfair or supercompensatory charges on shippers. Yet, the Board's decision has declared that all railroad programs that compute fuel surcharges as a percentage of existing rates, as KCSR's program does, constitute an unreasonable practice. KCSR respectfully disagrees with that conclusion, and respectfully suggests that the Board has neither followed the requisite adjudicatory procedures nor developed the factual record necessary to find KCSR's particular program to be an unreasonable practice under the Board's governing statute. See generally Shippers Comm., OT-5 v. Ann Arbor R.R., 5 I.C.C.2d 856, 863 (1989)(the Board must review the carriers' actions according to the relevant statutory provisions before declaring a practice unreasonable); accord, Liability for Contaminated Covered Hopper Cars, 10 I.C.C.2d 154, 168-69 (1994). Were such a record and

² KCSR endeavors to make its fuel surcharge program transparent to the public and its customers by explaining how KCSR calculates its fuel surcharges on its website and by sending bulletins to its shippers regarding any changes to the fuel surcharge program.

findings developed, KCSR believes that its fuel surcharge program would not be found to be an unreasonable practice.

While KCSR respectfully disagrees with the Board's policy conclusion that fuel surcharge programs like KCSR's are an unreasonable practice, KCSR recognizes the Board's concerns about current fuel surcharge practices in the industry and those of the shippers who have complained to the Board. KCS believes that certain provisions of the Board's proposals, would be difficult and expensive to adopt. KCSR also believes that the lack of industry-wide route mileage information and the differences of rate regulatory schemes in Mexico and Canada, along with other factors, would make implementing parts of the Board's proposal especially difficult for carriers with significant cross-border traffic or a high proportion of joint-line moves. Notwithstanding, KCSR has carefully reviewed its fuel surcharge program and believes it could meet the spirit of the Board's objectives.

II. THE BOARD'S PROPOSALS

A. Linkage Requirement

The Board has stated that recovering increased fuel costs experienced by carriers through the use of a fuel index-based percentage surcharge to a base rate is an unreasonable practice because base rates often are not cost-based but instead are determined by demand-based differential pricing and by shipping characteristics that are unrelated to the amount of fuel consumed to move a shipment. The Board has determined that any fuel surcharge should be "directly tied to and limited to the incremental changes in that particular cost for the movements to which the surcharge is applied." Rail Fuel Surcharges, STB Ex Parte No. 661 (served Aug. 3, 2006), slip op. at 4. To achieve that goal, the Board has expressed a preference for a mileage and weight-based fuel surcharge program or, at least, for a mileage-based program. This program

would require the railroads to apply the percentage increase in fuel costs to each particular car movement based upon how many miles (or ton/miles) that particular car traveled.

KCSR believes that it could, if needed, implement a fuel surcharge program that would more closely link the surcharge for a particular shipment to the use of fuel for that particular movement. However, implementing such a surcharge would need to be practicable considering the hundreds of thousands of shipments the railroad handles annually. Fuel consumption of a particular shipment depends not upon just mileage, but also upon shipment weight, route characteristics such as curvature and grade of the lines involved, speed of the train, train consist, whether the train is a local or a through train, the amount of switching required for pickup and delivery, the fuel efficiency of the locomotive, condition of the track, weather, etc. Keeping a record of all of these factors, even for local movements, would be extremely difficult, and would be nearly impossible to coordinate and analyze with respect to joint-line movements.

Although there have been tremendous advances in computerization of rail operations since the decision by the Board's predecessor Expedited Procedures for the Recovery of Fuel Costs, 350 I.C.C. 563 (1975), many of the difficulties recognized in that decision remain even with respect to instituting even a mileage-based surcharge for each shipment. Difficulties arise, for example, because carriers have multiple routing options between the same origin and destination. Different routes may be chosen at different times because of congestion, the length of a particular train and sidings needed to accommodate it, maintenance issues, weather, etc.

Clearly, it would be extremely difficult to take account of all the factors necessary to develop completely accurate data on fuel use linked to each shipment just on a carrier's own lines. Nevertheless, in an effort to not let the perfect be the enemy of the good, KCSR believes that if adequate implementation time is allowed, it would be possible for KCSR to initiate a system on local traffic that would meet the Board's principal objectives by adopting a surcharge

based on loaded car miles. The basis for this program would require development of a baseline measurement of the total number of loaded car miles of revenue freight (measure A). The incremental KCSR fuel expense resulting from fuel price increases above the base level (*i.e.*, \$23/bbl) (measure B) would also be calculated, perhaps using the previous quarter. The total incremental fuel expense - B - would be divided by total loaded car miles - A - to determine an incremental fuel expense per loaded freight car mile (measure C). KCS would use its MCS program to calculate how many miles each loaded car traveled on the KCSR system and, when the freight bill for the shipment was prepared, the loaded route miles for that shipment would be multiplied by measure C to create that shipment's fuel surcharge.

Even this system has difficulties. For example, if each carrier is responsible for applying and collecting the fuel surcharge on its portion of the move, KCSR would be required to produce a separate fuel surcharge bill for its portion of each joint-line move, notwithstanding that KCSR may not be the billing carrier. Likewise, KCSR's fuel surcharge program may not be identical to those of its connecting carriers; creating data interchange issues. Also, joint-line carriers could be applying different methodologies. One carrier might want to bill on a through basis while its connecting partner wanted to bill the fuel surcharge as a separate bill. If the interlining carrier was the billing carrier, or had priced the traffic based on its surcharge rather than KCSR's, KCSR could be disadvantaged. For example, the generally longer lengths of hauls on the larger carriers or more favorable terrain, may produce better fuel economies/efficiencies, which, if applied to the entire move, could prevent KCSR from recouping its fuel costs, potentially costing KCSR millions of dollars.³

Assuming KCSR could overcome these difficulties in response to the Board's proposal, KCSR believes that its suggested loaded car factor ("LCF") methodology is currently the most

³ KCSR's total fuel cost for August 2006 alone exceeded \$11 million.

suitable program for KCSR, if change is to be required. Nevertheless, implementation issues will be significant and costly. While information such as the mileage for each local shipment can likely be gained from KCS's MCS system, programming information systems to capture and utilize this information for rating and billing each shipment will not be an easy task. This will involve input from all of the various departments; IT, marketing, accounting, and others to reprogram MCS. This will also require parties in the field to change some of their inputs into the MCS system so as capture the appropriate data. This involves significant expense, management time, and employee retraining. KCSR believes that for a system to work uniformly for interline traffic, the rail industry would have to develop a mileage master covering all carriers and routes and a method to determine actual route of movement where alternative routes are available, as well as a system for computerized access to and updating of that information, altogether a major industry endeavor in and of itself.⁴ If instead, the industry did not develop such a system, but left each carrier to bill and collect for their own portion of the fuel surcharge, as might also be required if carriers utilized different methodologies, it would be somewhat less time-consuming for KCSR to implement the system, but would result in vastly increased costs in billing and collection functions for sending and collecting a fuel surcharge bill to each shipper whose shipment is handled en route by KCSR. Such costs should be an important part of the Board's consideration.⁵

⁴ Implementing a surcharge program based on weight as well as mileage would require a much more significant investment of time by KCSR and by other railroads.

⁵ Indeed, it does not appear that the Board, as required by precedent, took such costs into consideration when it simply declared application of all existing non-mileage based fuel surcharge programs an unreasonable practice. As stated in the Office of Management and Budget's Circular A-4, dated September 17, 2003, at 2 ("A good regulatory analysis is designed to inform the public and other parts of the Government (as well as the agency conducting the analysis) of the effects of alternative actions. . . . Benefit-cost analysis is a primary tool used for regulatory analysis."). See generally Chamber of Commerce v. SEC, 412 F.3d 133, (D.C. Cir.

Not only are there significant cost issues that need to be considered, but as noted, implementation of a mileage-based program, such as LCF, suffers from many of the same difficulties that existed in 1975 and that prevented KCSR from adopting such a program when KCSR first recognized the need to impose a fuel surcharge. While, as noted, MCS could be reprogrammed at significant cost to implement LCF on local KCSR moves, MCS will still only be able to provide KCSR with the LCF for a particular car or shipment for the KCSR portion of the move. For interline movements between KCSR and other carriers, KCSR will not be able to determine the LCF for the shipment while it is on the other carrier's system. Each interline carrier will now have to submit a separate bill for just the fuel surcharge component and just for the time the car was in its system.

Due to the difficulties of devising and implementing a fuel surcharge program as envisioned by the Board, KCSR respectfully requests that if the Board, after consideration of the comments, decides to proceed with a change in the current method of assessing fuel surcharges, the Board not impose a rapid or inflexible deadline for implementation of a mileage or mileage/weight based fuel surcharge system. As noted above, the implementation issues are significant and carriers should be provided sufficient time to develop and implement individually tailored fuel surcharge programs. Any changes to the current methods used to recover increased fuel charges should be implemented on a gradual basis. Time is needed to develop the systems to capture the measurements on which the new surcharge program would be based, to prepare company information systems to process that information, and to inform shippers through tariffs and otherwise of the new system. In particular, significant time likely would be needed to gather information from the large number of shortline railroads. Some shortlines do not currently have

2005)(Regulatory agency must consider the costs that a proposed rule would impose on the regulated entities).

EDI capability, and so might have to acquire that capacity in order to participate in an industrywide system, while for others the fuel surcharge is incorporated in the rate or division they receive rather than being itemized separately. Because fuel costs and fuel surcharges are presently very significant to overall carrier budgets, KCSR respectfully suggests that caution be taken in setting implementation goals to avoid precipitous and potentially damaging revenue and cost shifts.

KCSR also recommends that the Board make it clear that the application of any newly adopted fuel surcharge program is to be forward looking, not retroactive. The Board should specifically declare that it will not entertain requests for the retroactive application of any new fuel surcharge standards to past shipments.⁶

B. Double Dipping Prohibition

As the Board noted, base rates are sometimes escalated using an index, such as the Railroad Cost Adjustment Factor ("RCAF"). RCAF does include changes in the cost of fuel as a component of the index. In fact, fuel costs represent 12.1% of the overall RCAF weighted inputs, although recent calculations show that the fuel cost component is slated to increase to 16% of the weighted inputs. Letter from Craig Rockey, Vice President – Economics and Policy, Association of American Railroads, to Secretary Vernon A. Williams, dated September 5, 2006. Because it is possible that in some instances it may be construed as having resulted in double recovery for the same fuel costs increase by both escalating the base rate using an RCAF index and applying a fuel surcharge, the STB is proposing to prohibit railroads from this practice, unless the railroad first subtracts out any fuel cost component from the relevant index.

⁶ KCSR does not believe the Board would have the legal authority to retroactively apply any new fuel surcharge program to past shipments. Arizona Grocery Co. v. Atchison, T. & S.F. Ry., 284 U.S. 370 (1932). See also Rail Fuel Surcharges, STB Ex Parte No. 661 (served Aug. 3, 2006) at notes 9 and 11.

KCSR shares the Board's goals that carriers should not be getting paid twice for the same fuel increase. Accordingly, KCSR agrees that any imposition of a fuel surcharge based upon application of its proposed LCF fuel surcharge program to a particular non-exempt shipment subject to the Board's regulatory authority⁷ should not be done in addition to a cost increase based upon a non-discounted RCAF (or similar index).

C. Appropriate Index of Fuel Cost Increases

As has been noted throughout this proceeding, carriers use a variety of indices to determine what, if any, increases in fuel costs have occurred and then apply that percentage change in the index to the base rates or a combination of base rates and mileage-specific movements to determine the fuel surcharge. Instead of allowing carriers the option of continuing to utilize indices that are appropriate to an individual railroad, the STB has proposed that the railroads adopt a "single, uniform index for measuring increases in the fuel costs" and has proposed the use of the Energy Information Administration's U.S. No. 2 Diesel Retail Sales by All Sellers (cents per gallon)("EIA Index"). At this time, and without further study, KCSR does not support this proposal.

There are simply too many unknowns about this index and its applicability to measuring railroad fuel costs. While KCSR is encouraged by the strong correlation with the Association of American Railroad's ("AAR's") fuel cost index and the apparent short time lag in measuring cost increases, KCSR believes more study is needed. KCSR proposes that the STB request AAR to study the various potentially-applicable fuel indices to identify the one that is the most

⁷ The Board does not have the authority to declare imposition of a fuel surcharge provision within a contract as an unreasonable practice nor can the Board regulate the provisions of a contract. Kansas City Power & Light Co. v. Union Pac. R.R. Co., STB Docket No. 42095 (STB served July 27, 2006), slip op. at 1. See also 49 U.S.C. §10709(c)(1) ("A contract that is authorized by this section . . . shall not be subject to this part, and may not be subsequently challenged before the Board or in any court on the grounds that such contract violates a provision of this part.")

immediately sensitive to price hikes for fuel actually consumed by long-haul rail movements and which the railroads have the ability to implement with a minimum of cost. The STB's proposal to use the EIA's "U.S. No. 2 Diesel Retail Sales by All Sellers" may in fact be the best methodology, but AAR should study the issue. Cf. Investigation Of Railroad Freight Service, Ex Parte No. 270 (Sub-No. 2), 345 I.C.C. 2941 (1978).

D. Reporting Requirement

Finally, the Board has requested the railroads to provide a monthly report showing "actual fuel costs, total fuel consumption, and total fuel surcharge revenues." In the appendix of the August 3rd decision, the Board has proposed a certain format and form for such reporting. The form requests each Class I carrier to report total expenditures for fuel, total gallons of fuel consumed, the increase or decrease in its cost of the fuel from the previous month, revenue tons for the month, and revenue tons to which a fuel surcharge was applied. The form also requires each Class I railroad to report the revenue it collects on joint shipments with Class II and Class III carriers, and report the revenues from fuel surcharges shared with Class II and Class III carriers.

KCSR does not oppose some form of general reporting requirement; however, KCSR believes there are significant problems with the proposed reporting requirements. KCSR can comply with Items 1, 2, and 2(a) and did so on September 20. With respect to Items 4 & 5 of the reporting form, KCSR's systems are not presently capable of obtaining this information. The system cannot presently segregate KCSR's portion of the revenue that KCSR collects on joint shipments with Class II and Class III carriers nor can it separate the revenues from fuel surcharges shared with Class II and Class III carriers. KCSR likewise does not account for fuel surcharges on a ton-mile basis so as to be able to provide the information requested in Items 6 & 7. KCSR could, at substantial expense and manpower usage, reprogram its information

technology (“IT”) systems to capture this information and retrain its employees in the field to implement this information into the system, but even then, the Class II’s and Class III’s that KCSR interchanges with use their own IT systems that are not necessarily compatible with how KCSR would capture and share fuel surcharge revenues.

Assuming these IT issues could be resolved, there are still other issues that the Board needs to consider. First, there would be significant cost issues associated with the Board’s reporting requirement. Second, there are also legal issues regarding the confidentiality of the fuel surcharge information and the Board’s proposal to publicly disclose information garnered in part from confidential contracts with shippers and with shortline connections and filed with the Board under its proposed reporting requirements.

As a result of these concerns, KCSR recommends that the proposed report not include Items 4, 5, 6 or 7. As for Item 3, KCSR recommends that only revenues from fuel surcharges imposed on non-contract traffic be included because the Board lacks authority to regulate service under contract and concerns regarding reporting revenues from shipments that are subject to confidentiality provisions.

To encourage compliance with the Board’s proposed rules, if they are adopted, and to provide incentives for the carriers to work with their shippers to develop industry-based solutions to the fuel surcharge problems, rather than Board-imposed regulation, KCSR believes the Board should adopt an incentive based reporting requirement. Under such a program, if a carrier adopts a fuel surcharge system that is consistent with the Board's guidelines, then that carrier should be relieved from the reporting requirements. Such an incentive-based program is consistent with other reporting programs implemented at other agencies.

III. CONCLUSION

In conclusion, KCSR appreciates the opportunity to provide its views on the Board's proposed fuel surcharge program. As noted, KCSR believes that while the Board's proposals seek to redress perceived inequities in the current fuel cost recovery programs of various carriers some aspects of the Board's proposal would be difficult and expensive to implement and may prevent carriers from recovering legitimate cost increases. As briefly noted by KCSR herein and as consistent with AAR's comments, which KCSR fully supports, there are serious legal questions regarding the ability of the Board to regulate fuel surcharges as a practice rather than as a rate. The case law shows that fuel surcharges are a rate and not a practice. Conrail Surcharge on Pulpboard, 362 I.C.C. 740 (1980). There are also significant implementation issues with the Board's proposal as the record thus far does not show that implementation is feasible or practicable for joint line movements. KCSR also joins the industry's position that the Board cannot regulate the fuel surcharge applicable to contract traffic, as well as AAR's position that this agency cannot apply its proposed fuel surcharge program on exempt traffic absent appropriate proceedings to consider revocation of such exemptions under the standards set by the statute. Any change in the method of recovery for increased fuel charges should only be prospective. Without the fuel surcharge, carriers would have been forced to increase rates to recover fuel price increases. With the fuel surcharges, as fuel costs decrease, the effective rate the shipper pays also decreases. KCSR believes that its suggested LCF method fits within the Board's guidelines and would meet the Board's objectives.

KCSR is hopeful that the Board, while doing what it can to foster dialogue and understanding between the railroads and their customers, will not impose its proposed conclusions and reporting requirements on the rail industry unchanged from that proposed in the August 3 decision. KCSR is committed to working with its customers and the Board to resolve

the concerns regarding the current fuel surcharge programs. While changes can be made, such changes should be the result of mutual discussions and not government imposed mandates.

Respectfully submitted

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