

Before the U.S. Surface Transportation Board

STB Ex Parte No. 661 (Sub-No. 2)
Rail Fuel Surcharges (Safe Harbor)

Comments of the
U.S. Department of Agriculture

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Authority and Interest

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board proceedings involving rates, charges, tariffs, practices, and services.

Introduction

Fuel surcharges allow railroad firms to recover from shippers the proportion of costs caused by abnormally high fuel prices not reflected in the base rate. Although fuel costs have always been included as part of the rail freight rate, a rapid increase in fuel prices encouraged railroads to add separate fuel surcharges in an effort to recover additional fuel costs incurred. When first implemented, railroads used an estimate of these additional fuel costs based upon a percentage of the rail rate.

As fuel surcharges rapidly escalated, shippers became increasingly concerned that fuel surcharges were becoming profit centers for the railroads and that rate-based fuel surcharges did not fairly apportion the additional cost of fuel among shippers.

Following public concern over the railroad industry's application of fuel surcharges, the Board instituted a proceeding to investigate railroad fuel surcharges. During the proceeding, the Board exercised its authority to address the reasonableness of railroad practices, determining the practice of applying a fuel surcharge that recoups more than the increased fuel costs reflected in a base rate constituted an unreasonable practice. As a result, the Board designed measures to preclude such an unreasonable practice.

In its January 26, 2007 decision in Rail Fuel Surcharges,¹ the U.S. Surface Transportation Board (Board) prohibited rate-based fuel surcharges as an unreasonable practice and established as a "safe harbor" the U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon) (HDF index), upon which railroads could rely to measure changes in fuel costs and administer fuel surcharge programs. In a later complaint proceeding, Cargill² challenged BNSF Railway's (BNSF) fuel surcharge program. A critical issue in Cargill's complaint was the manner in which BNSF's incremental fuel costs should be measured. Relying on the safe harbor provision, the Board ruled against Cargill.

The U.S. Department of Agriculture (USDA) appreciates the opportunity to comment on whether the safe harbor provision of the Board's current rail fuel surcharge rules should be modified or removed. In particular, the Board seeks comments on:

- Whether a growing spread between a railroad's internal fuel costs and the safe harbor index, as observed in Cargill, is likely an aberration;

¹ Surface Transportation Board Ex Parte 661, *Railroad Fuel Surcharges*, decided January 25, 2007.

² Surface Transportation Board Docket No. NOR 42120, *Cargill, Incorporated v. BNSF Railway Company*, Decided August 9, 2013.

- If problems are associated with the Board’s use of the index as a safe harbor in judging the reasonableness of fuel surcharge programs;
- Whether problems with the safe harbor could be addressed through its modification; and
- If problems with the safe harbor outweigh its benefits.

Spread Between Fuel Costs and HDF Index Is Likely Not An Aberration

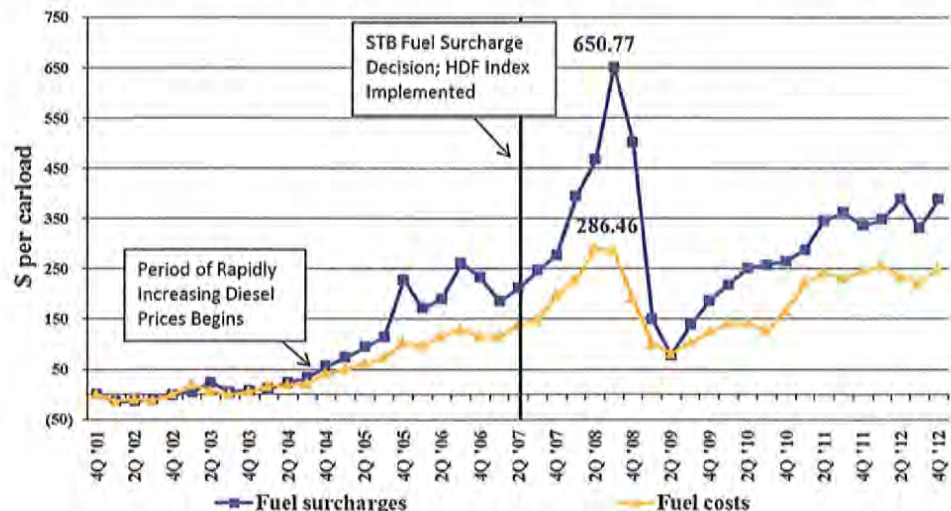
During the Board’s Ex Parte 661, some shippers suggested that fuel surcharges be limited to the changes in fuel prices from a defined starting point and that shippers be able to separately challenge surcharges that exceed the change in fuel costs for their particular movement.³ This is because they wanted a reasonable benchmark period from which to measure the most recent changes in fuel surcharges. A reasonable starting point for comparing the growth in fuel surcharges against the growth in actual fuel costs would be from before fuel surcharge programs were widely implemented. By nature, the starting point of an index acts as the reference point from which all change is measured in each subsequent period. Thus, the starting point should be chosen so as to occur before any widespread changes in the growth rates between fuel surcharges and fuel costs.

Accordingly, in the analysis provided below, USDA used the 4th quarter of 2001 as the starting point, which is when fuel surcharges actually started being used in the market and is also prior to the divergence between the growth rates in fuel surcharges versus fuel costs that began in 2004. In contrast, a starting point such as the 4th quarter of 2007, when railroads were first required to submit their surcharge revenue to the Board, underrepresents the actual growth in fuel surcharges prior to a start date of 2007. Thus, from USDA’s perspective, excluding the growth in fuel

surcharges that occurred from 2001 to 2007 led to a substantial over recovery of fuel costs. Furthermore, if this over recovery of fuel costs is not addressed in the future, railroads will continue to over recover fuel costs.

Figure 1 shows the growth in railroad grain fuel surcharges compared to the growth in railroad fuel costs in dollars per carload. When on-highway diesel fuel prices were relatively low or on-highway diesel prices were decreasing

Figure 1: Growth in Railroad Grain Fuel Surcharges v. Growth in Railroad Fuel Costs by Quarter¹



¹ For the 7 Class 1 railroads operating in the United States. Weighted average fuel surcharges per carload were estimated by multiplying the average length of haul for grain by the quarterly weighted average fuel surcharge per carload mile. Weighted average fuel surcharge per carload mile prior to 2Q '06 was estimated using mileage-based fuel surcharge formulas for individual railroads. Source: Class I Railroad quarterly filings to the Security and Exchange Commission; AAR, The Rail Transportation of Grain (2009)

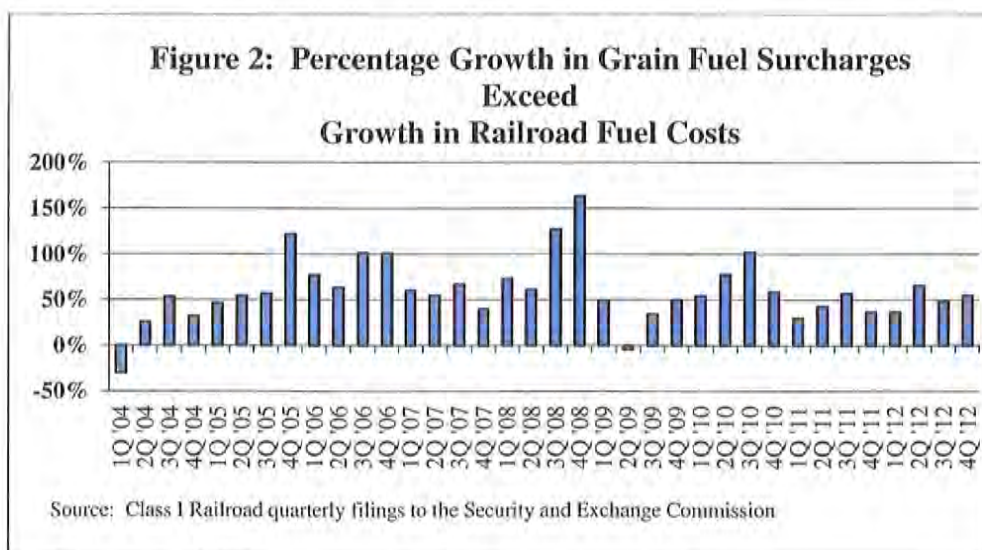
³ Surface Transportation Board Ex Parte 661, *Railroad Fuel Surcharges*, January 26, 2007, page 2.

(4th quarter 2001 through 4th quarter 2004; 2nd quarter 2009), the growth in railroad grain fuel surcharges was approximately the same as the growth in railroad fuel costs. However, since then, as the price of on-highway diesel fuel increased, a substantial spread between the growth in fuel surcharges and growth in railroad fuel costs developed.

At their height during the 3rd quarter of 2008, the growth in railroad fuel surcharges exceeded the growth in railroad fuel costs by an average of \$364 per carload, relative to the 4th quarter of 2001, across all 7 Class I railroads. For perspective, \$364 per car is the equivalent of \$0.09 per bushel of grain.

Using the 4th quarter of 2001 as a benchmark, the average quarterly growth in fuel surcharges was \$307.89 per car from the 2nd quarter of 2007 through the 4th quarter of 2012. This compares to an average growth in railroad fuel costs of only \$190.08 per car. This indicates that, on average, the growth in railroad fuel surcharges was greater than the growth in railroad fuel costs on an industrywide basis by \$117.81 per car, or 62 percent.

The percentage the growth in grain fuel surcharges exceeds the growth in railroad fuel costs ranges from a negative 30 percent to 163 percent (see Figure 2). Note that there are only two quarters where the percentage growth in grain fuel surcharges are less than the growth in railroad fuel costs.



HDF Index Alone Does Not Ensure the Reasonableness of Fuel Surcharges

As shown in *Cargill*,⁴ fuel surcharges can constitute large sums even when the railroad uses the On-Highway Diesel Fuel Index. The railroad may have set the strike price⁵ too low or may have set the rate of the fuel surcharge increase too high. The fuel surcharge over recovery can involve millions of dollars, even for a single shipper.

⁴ Surface Transportation Board Docket No. NOR 42120, *Cargill, Incorporated v. BNSF Railway Company*, Decided August 9, 2013.

⁵ The strike price is the on-highway diesel fuel price where the railroad's fuel surcharge program takes effect.

At the time of the Cargill filing (May 2010), fuel surcharge rates ranged from \$0.1208 per railcar mile for Canadian National Railway (CN) to \$0.42 for BNSF. The BNSF rate was 348 percent that of CN. This high differential between rates seems to indicate that the on-highway diesel fuel index, on its own, is not a suitable method for measuring changes in fuel surcharges that are reasonably close to changes in internal fuel costs of individual railroads.

Clarification of Safe Harbor

USDA believes the use of a “safe harbor” is inherently uncertain, can lead to ambiguity, and therefore is prone to misinterpretation. Due to these shortcomings, USDA cautions the Board in using safe harbors. USDA and most shippers had interpreted the Board’s safe harbor provision as simply providing guidance on which index railroads should use as a proxy for incremental fuel costs. Our interpretation was if any other index other than the On-Highway Diesel Fuel Index was used it would be subject to challenge. We never expected the safe harbor provision would be used to grant railroads immunity from the Board’s directive against fuel surcharges being used as profit centers.

As the Board has noted, a drawback of the safe harbor is that it currently allows a rail carrier to recover more than its incremental fuel costs as measured by its actual internal fuel costs where changes in the HDF index fail to accurately reflect changes in a rail carrier’s internal costs.⁶ Furthermore, the Board stated the safe harbor provides rail carriers with an unintended advantage by immunizing carriers against any over recoveries of fuel costs in the case when a carrier’s internal fuel costs decline over time relative to the HDF index.⁷ However, the Board also noted that “the safe harbor ... does not immunize a rail carrier’s fuel surcharge program from challenge simply because the program uses the HDF index.”⁸ The example given of such an unreasonable fuel surcharge program is a mileage-based surcharge that rests upon an unreasonable assumption about the fuel efficiency of the traffic to which it applies, leading the Board to conclude the program lacks a reasonable nexus to fuel consumption.

Exactly which scenarios can or cannot be immunized by the safe harbor are not clearly understood. On its face, many shippers may not be able to easily distinguish between an over recovery of fuel surcharges due to a failure to accurately reflect changes in a rail carrier’s internal costs versus an over recovery based on an unreasonable assumption that lacks a reasonable nexus to fuel consumption. Without an objective metric available to shippers, the seeming ambiguity may dissuade shippers from challenging any fuel surcharge program in the future, essentially insulating carriers’ programs from challenge.

USDA believes the major shortcoming of the safe harbor is in granting immunity under certain scenarios for over recovery of fuel surcharges. Such immunity directly undermines the Board’s paramount objective in these proceedings of preventing fuel surcharges from becoming profit centers and over recovering fuel costs by creating a loophole through which fuel surcharges continue to operate as profit centers. Therefore, USDA recommends the safe harbor be amended

⁶ Cargill Decision at 17

⁷ Cargill Decision at 17

⁸ Cargill Decision at 9

to comport with the Board's primary objective than have it removed and potentially introduce uncertainty into the market.

Modifying the Safe Harbor

If the Board chooses to modify the safe harbor instead of remove it, USDA believes eliminating immunity for over recovery is the best area in which to focus. It is not obvious in what other way the safe harbor could be modified without eliminating it or the functionality of the HDF index all together.

Furthermore, it is unclear what removing the safe harbor would mean in practice. The Board has directly linked the HDF index with the safe harbor in Cargill.⁹ To eliminate the safe harbor would seem to indicate eliminating the HDF index, leaving rail carriers with no approved index on which to base their fuel surcharge programs. Furthermore, shippers strongly advocated for the usage of an index that ensured accuracy, transparency, and accountability in order to enhance the credibility of fuel surcharge programs. Removing the safe harbor would be to leave railroads insecure with regard to setting incremental fuel cost increases and shippers vulnerable to a dubious surcharge mechanism, necessitating some other index to fulfil this role. Yet, this new index would become the *de facto* safe harbor and likely suffer from the same shortcomings currently afflicting the HDF index unless the safe harbor designation can be redefined or modified to remove the immunity.

Aside from immunity, USDA does not believe there is anything fundamentally wrong with using the HDF index as a safe harbor. Except for an index based upon actual internal railroad fuel expenditures for each carrier, any other index will be, as observed by the Board, at best a proxy to actual changes in fuel costs. Thus, it will deviate to some degree from actual fuel expenditures. The objective of any index is to minimize this deviation, and from the record, the HDF index appears to be the best candidate to fulfil this objective, if appropriately calibrated to a suitable starting period that acts as an accurate reference point from which all change is measured in each subsequent period. The usage of any index should be subject to the Board's paramount objective of preventing fuel surcharges from becoming profit centers and over recovering fuel costs.

USDA believes devising an index that perfectly coincides with actual internal fuel costs is beyond the capability of the Board, shippers, or railroads. Complicating factors affecting fuel costs that have been mentioned previously include speed, intensity of local switching, empty return ratio, track conditions, geography, grade, curvature, drag and resistance, weather conditions, and overall operating conditions in addition to mileage. Many of these factors cannot be accounted for until after the movement is complete, indicating the impossibility of devising a perfectly accurate index that can measure incremental fuel costs prior to the movement taking place. As a result, the burden rests not on the Board or interested parties to find a golden index nor on any specific index to perform without failure; the burden rests on individual rail carriers to finely calibrate their fuel surcharge program to bear a reasonable nexus to actual internal fuel costs throughout the life of their fuel surcharge programs.

⁹ Surface Transportation Board Docket No. NOR 42120, *Cargill, Incorporated v. BNSF Railway Company*, Decided August 9, 2013.

Therefore, USDA believes the focus of this proceeding should be on ensuring that rail carriers, either intentionally or unintentionally, do not take advantage of the safe harbor provision to over recover fuel surcharges. It would seem common sense and unavoidable that periodic exercises are carried out by rail carriers to ensure their fuel surcharges bear a reasonable nexus to actual fuel costs. As circumstances change with regard to fuel costs, a carrier should be obligated to ensure the changes are implemented within its fuel surcharge program so as to maintain a reasonable nexus between changes in the HDF index and changes in internal fuel costs, and if not, the Board should require the railroad to refund the difference to their customers.

Additional Reporting

USDA believes additional reporting would ensure a reasonable nexus between changes in the HDF index and changes in carrier's internal fuel costs are maintained. From carriers' Quarterly Reports of Rail Fuel Surcharges, the Board and interested parties should be able to monitor the reasonability of the nexus between fuel consumption and fuel surcharges. The Board stressed that reporting of fuel expenditures and consumption would enable the Board to better monitor the industry's fuel surcharge practices. USDA believes additional transparency in the Quarterly Report of Rail Fuel Surcharges is warranted.

Except for a lengthy and costly rate complaint case brought under 49 U.S.C. § 10702(2), there is no way to ensure that a rail fuel surcharge accurately reflects the rail carrier's increased cost of fuel. Even with an accurate, publicly available fuel surcharge index at the Board's disposal, the Board found an opportunity existed for a rail carrier to over recover its internal fuel costs using a fuel surcharge program.¹⁰ USDA believes the best way to prevent this from occurring in the future is to make additional information available through the Quarterly Reports of Rail Fuel Surcharges to include the total revenue allocated to fuel costs collected through the base rate, total internal fuel costs, the difference between internal fuel costs and the amount collected through fuel surcharge revenues, and any other such information that would reduce the need of shippers from having to file a complaint under 49 U.S.C. § 10702(2) for the purpose of ensuring the reasonability of a rail carrier's fuel surcharge program. The Quarterly Reports of Rail Fuel Surcharges should make determining whether and by how much a rail carrier's fuel surcharge program is over recovering fuel costs obvious and transparent to all, which currently is not the case. Similarly, relying on annual R-1 reports or lengthy rate complaints to gauge the reasonableness of fuel surcharge programs with the actual cost of fuel will insulate rail carriers from compliance with the Board's directive.

In the case where a rail carrier has over recovered its fuel costs, these should be returned to shippers by some means such as a credit on fuel costs in subsequent periods or through direct payments. Thus, carriers would have no incentive to use fuel surcharges as profit centers and would instead be incentivized to update the mechanisms of their fuel surcharge program to reflect the most accurate information available to them as circumstances change.

¹⁰ The Board calculated BNSF's fuel surcharge revenues exceeded its incremental fuel costs by some \$181 million over five years in its decision in Surface Transportation Board Docket No. NOR 42120, *Cargill, Incorporated v. BNSF Railway Company*, Decided August 9, 2013.

Conclusion

USDA believes the benefits of the safe harbor by way of continuing to use the HDF index to measure incremental fuel costs outweigh any drawbacks and advocates it be retained for the purposes of providing accuracy, transparency, and accountability in the marketplace. Its use is widespread and easily understood by both rail carriers and shippers. However, USDA believes the safe harbor as it is currently defined needs to be modified so as to remove any and all immunities noted by the Board for any and all such circumstances that allow rail carriers to recover more than their incremental fuel costs as measured by their actual internal fuel costs. Thus, the responsibility is incumbent upon rail carriers to continually update and ensure their fuel surcharge programs bear a reasonable nexus to changes in their internal fuel costs and changes in the HDF Index. USDA recommends additional reporting by the railroads in the Quarterly Report of Rail Fuel Surcharges for the purposes of monitoring and ensuring the Board's paramount objective of preventing the unreasonable practice of fuel surcharges from acting as profit centers.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Edward Avalos", written over a horizontal line.

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CERTIFICATE OF SERVICE

I, Bruce Blanton, certify that on this 1st day of August, 2014, caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Docket Number EP 661 (Sub-No. 2).



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