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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 661

REVIEW OF RAIL FUEL SURCHARGES

COMMENTS OF THE AES CORPORATION

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I. INTRODUCTION

On March 14, 2006, the Surface Transportation Board ("Board" of "STB") issued a notice of public hearing to be held on railroad fuel surcharges on May 11, 2006, and requested comments and testimony from interested parties ("Notice"). The AES Corporation ("AES") hereby submits these comments in response to the Board's invitation. The Board has also allotted AES ten minutes to speak at the May 11 hearing. AES's testimony will summarize the main points of these comments.

A. Identification and Interest of The AES Corporation

The AES Corporation is a holding company with headquarters in Arlington, Virginia. It is a global power company with subsidiaries throughout the world. The AES Corporation, through its subsidiaries, operates approximately 20 electric generating facilities in the United States. Nine of these facilities are rail-served coal-fired generating stations.¹ Coal is delivered to these facilities in single line and joint-line service by the BNSF Railway Company ("BNSF"), Norfolk Southern Railway Company ("NS"), CSX Transportation Company ("CSXT"), and the

¹ For the sake of convenience, The AES Corporation and its US subsidiaries that own rail-served coal-fired generating stations are referred to herein as "AES."

Kansas City Southern Railroad ("KCS"). BNSF, NS, and CSXT assess AES fuel surcharges in addition to the base railroad rates and other charges set forth in transportation contracts. These fuel surcharges have been established in public pricing circulars and other documents setting forth the respective railroad's common carrier terms for providing coal transportation service.

B. Summary of Comments

Since 2001, as rail transportation contracts for AES's coal-fired plants have come up for renewal, AES has increasingly been assessed fuel surcharges by the Class I railroads serving these facilities, while at the same time enduring large increases in the level of base rates for transportation. AES does not object to railroads recovering the fuel costs associated with a particular movement as long as (1) the mechanism used for this purpose is expressly limited to recovering increases and refunding decreases in the fuel costs built into the transportation rate to which the mechanism applies; and (2) the mechanism and the fuel costs it uses are transparent and subject to regulatory oversight. Specifically, to the extent a movement does not utilize the RCAF, in which case no surcharge is appropriate, a surcharge that was fair to both parties would track the increases and decreases in an agreed upon or established price per gallon of diesel fuel at the time the rate went into effect, multiplied by the number of gallons consumed by the movement. As the price of diesel fuel increased or decreased over the term of the contract or common carrier movement, the shipper would be responsible for paying the increases, but the shipper would also be credited for decreases.

As explained in Section III of these comments, the revenues received by the Class I railroads pursuant to the fuel surcharge formulas they have established in various pricing circulars and other public documents, which have been incorporated into new transportation contracts by reference, have overcompensated the railroads for their actual fuel costs associated

with AES's individual movements. AES believes it can demonstrate this for each of its coal movements. However, since AES's coal movements are presently governed by confidential contracts, this analysis cannot be presented to the STB in this public forum. In fact, it is the railroads that hold the critical data the Board needs to fully evaluate the manner in which fuel surcharges are calculated and what correlation, if any, those calculations have to the railroads' actual costs. This is why transparency and STB oversight are so crucial. Hence, AES believes that the Board's review of the current rail fuel surcharge practices is crucial for all shippers.

The current fuel surcharges assessed by the railroads referenced above constitute unreasonable practices under 49 U.S.C. § 10702 because they are clearly rate increases as opposed to mechanisms to recover temporary spikes in fuel costs for particular movements, as claimed by the railroads. The Board should establish narrow, cost-based standards for permitting railroad fuel surcharges that permit a railroad to recover only significant, documented increases in fuel costs that are not accounted for by other means, such as the Rail Cost Adjustment Factor ("RCAF"), which already enables the carriers to fully recover changes in their costs of fuel for a particular movement. A fuel surcharge on top of the RCAF essentially allows a railroad to assess a shipper twice for the same fuel. The Board's predecessor previously considered this very issue and determined that fuel surcharges were not appropriate when rates were adjusted using the RCAF. Moreover, a permissible fuel surcharge should provide for both positive and negative fuel surcharges, *i.e.*, permit railroads to recover significant cost increases but also permit their customers to be refunded significant fuel cost decreases.

The Board should also recognize that the recent use by individual railroads of the All-Inclusive Index Less Fuel ("AIILF") developed by the Association of American Railroads ("AAR") in conjunction with a fuel surcharge in lieu of the RCAF is not an alternative or

industry practice arrived at via mutual agreement by shippers and railroads. Rather, the advent of the AILF in recent years is more a reflection of the significant market power and negotiating leverage currently possessed by the Class I railroads. The use of the railroads' published fuel surcharges as a surrogate for a fuel price index results in significant over-recovery of fuel costs for a particular movement.

In this proceeding, the Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate under the Board's authority to regulate railroad practices; (2) clarify that railroad fuel surcharges may only be used for the purpose of recovering or refunding actual costs of fuel expended for a particular shipper's transportation that are not adjusted for by other means; (3) take appropriate action to modify the current publicly published railroad fuel surcharges of BNSF, NS, CSX, and other similarly imposed railroad surcharges to the extent they do not comport with the above standard; and (4) require each railroad to submit detailed data reflecting their actual cost of fuel and the revenues associated with fuel cost recovery associated with each individual movement for which the fuel surcharge is assessed.

II. STB AUTHORITY TO REVIEW RAILROAD FUEL SURCHARGES

A. Interstate Commerce Commission Treatment of Fuel Surcharges

1. The Ex Parte No. 311 Proceeding

This proceeding is not the first time fuel surcharges have come to the attention of federal regulators, or the first time railroad fuel surcharges have been questioned for over-recovering fuel costs. Prior to passage of the Staggers Rail Act of 1980² and the adoption of the RCAF discussed below, railroads had to seek prior approval of any rate increases, and approved

² Staggers Rail Act of 1980; 96 P.L. 448 (October 14, 1980).

increases could not go into effect for 30-45 days.³ When fuel supplies were threatened by the Arab oil embargo in 1973, the Interstate Commerce Commission ("ICC") determined that the existing process for general rate increases, including the 30-45 day waiting period, "may not be adequate in the present circumstances to offset anticipated increases in fuel prices." 40 Fed. Reg. 5374 (1975). It commenced a proceeding in order to allow railroads and motor carriers to increase transportation rates more expeditiously. *Ex Parte No. 311, Effect of Modifying Proclamation No. 3279 and Other Anticipated Energy Conservation Measures on the Operation of Carriers Subject to the Interstate Commerce Act*, 350 ICC 563, 564 (1975) ("Ex Parte No. 311"). After a comment period, the ICC adopted expedited procedures providing interim relief from the regular 30-day notice required, but only if fuel prices were to escalate in the future as expected. *Id.* at 567.

In allowing this interim relief, the ICC declined to use fuel surcharges. Specifically, the ICC had permitted the imposition of fuel surcharges on an "experimental basis" in 1973-74, primarily for motor carriers. *Id.* at 566. In *Ex Parte No. 311* the ICC clarified that

It has been the traditional view of this Commission that surcharges which add an element of confusion into tariff use should only be sanctioned in unusual situations. Generally, surcharges have only been considered as appropriate in situations where it is anticipated that their use will be of temporary duration or where in extenuating situations the service performed under the surcharge is considered local to the carrier assessing the charge.

Id. at 572 (emphasis added). Lastly, the ICC noted that while the price of fuel appeared as if it would remain higher for the foreseeable future, "the surcharge method of computing freight charges" was not an appropriate way to increase rates permanently. *Id.*

³ See former 49 USC § 10762, as described in, e.g., *The Hanna Mining Company v. The Escanaba and Lake Superior Railroad Co.*, 498 F.Supp. 1267, 1269 (E.D. Mich. 1980).

Because the ICC did not implement the expedited procedures adopted in *Ex Parte No. 311* until 1979, and railroads did not begin recovering the high fuel costs of 1973-74 until June of 1979, the ICC in 1980 approved a 1.2% railroad fuel surcharge instituted as a general rate increase. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge, April 11, 1980*, 364 ICC 336 (1980). In this decision, the ICC utilized the *Ex Parte No. 311* procedures ("even though...created for different purposes") because they represented the "best way to consider a fuel related surcharge." *Id.* at 337-338. The ICC initially declined to adjust the application of the surcharge on an individual shipper basis, but in response to a successful appeal by Central Power & Light Company, the ICC removed the 1.2% surcharge as applied to that shipper because it shipped no traffic during the period in question. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge, April 11, 1980*, 365 ICC 299 (1981). The ICC eventually permitted a total of 4.7% of such surcharges to account for the delay in implementing *Ex Parte No. 311*. ICC Docket No. 37316, *Rates on Coal, Decker and Kleenburn to Illinois and Indiana*, 364 ICC 158, 160 (1980) (describing ICC use of *Ex Parte No. 311* to authorize fuel surcharge of 4.7% in the first nine and a half months of 1979). In several instances, railroads tried to apply the 4.7% increase to individual movements that were already subject to existing rate escalation arrangements. In these cases, however, the criteria utilized by the ICC to determine whether application of the surcharge was appropriate included whether the revenue generated by the surcharge was justified by the actual fuel costs incurred by the railroad or railroads to provide the service to that particular shipper or shipper or group of shippers, and whether the railroad was recovering fuel costs by other means. *Id.*, 364 ICC 158 (1980); and ICC Docket No. 37315F, *Coal, Colstrip, Kuehn, and Decker, MT to Superior, WI*, 364 ICC 152 (1980). In the latter case, the ICC noted in particular that the railroad did not demonstrate that it

would be harmed by waiting until it recovered the additional fuel costs for that movement through operation of the rate adjustment provision that had been agreed upon by the parties. *Id.* at 156.

In summary, prior to the passage of the Staggers Rail Act of 1980 and the development of the RCAF, the ICC only permitted fuel surcharges in very narrowly prescribed circumstances to permit recovery of extraordinary and temporary increases in fuel costs prior to recovering such costs in rate increases or through a rate adjustment provision. Moreover, attempts to broadly apply surcharges to individual movements required some showing that the revenues generated by the surcharge did not exceed the actual fuel costs, particularly as parties developed rate adjustment indexes and formulas that would enable the eventual recovery of the costs of moving the shipper's traffic, including fuel costs.

2. The Effect of the Adoption of the Rail Cost Adjustment Factor on Fuel Surcharges

In part at the behest of Congress, the ICC proposed in 1980 to replace the procedures for filing general rate increases with a procedure based on an inflation index, the RCAF. *Advance Notice of Proposed Rulemaking*, 45 Fed. Reg. 29103 (May 1, 1980). In publishing the proposed rules, the ICC stated that "the procedures proposed in this notice will permit railroads to recover fuel cost increases along with other cost increases on a quarterly basis...We thus propose that our current Ex Parte 311 fuel surcharge mechanism be discontinued." Ex Parte 290 (Sub No. 2), *Railroad Cost Recovery Procedures* 45 Fed. Reg. 81217 (Dec. 10, 1980).

The ICC adopted the newly-created RCAF railroad index just a few months later in April of 1981. Ex Parte 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, 364 ICC 841 (1981). According to the ICC, adoption of this index "permit[s] railroads to recover fuel cost increases along with other cost increases on a quarterly basis." *Id.* at 852. Furthermore, the RCAF meant

that "[m]aintaining a separate surcharge mechanism for fuel would, in our view, serve no useful purpose once these rules are in place, and would, in fact, only complicate the operation of the new system." *Id.*

A few years later, the ICC adopted a revised methodology for the RCAF index based on data gathered and submitted by Association of American Railroads ("AAR"). Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, 1 ICC 2d 207 (1984). In stating again that the creation of RCAF was in response to the Staggers Act, the ICC noted that "[w]e believe it was the intent of that Act to simplify the procedures for increasing rail rates and that the application of the single RCAF to all base rates best accomplishes that intent." *Id.* at 208. For the fuel component of the RCAF, the ICC considered a variety of shipper proposals but eventually decided that a survey of actual prices paid by railroads, which was proposed by the AAR, is the best measure of the price of railroad diesel fuel. *Id.* at 217-218.

These statements from the ICC reveal that the RCAF was intended to not only replace the general rate increase method of adjusting rail rates with a simpler method, but also to supplant the need for fuel surcharges. Shippers and the AAR proposed competing methods of incorporating the price of fuel into the RCAF, but the ICC chose the AAR's method. In other words, in response to the ICC's request for rate adjustment methods that would replace the fuel surcharge mechanism, the railroads developed a method for incorporating fuel prices that was approved by the ICC. Any change to this railroad-proposed and ICC-approved mechanism for incorporating fuel prices in rates should only come in a regulatory rulemaking.

The RCAF index is based on quarterly filings made by the AAR. These filings include a forecasted railroad fuel cost for the next calendar quarter which is a mix of (1) actual diesel prices paid by railroads (for the weighting component) and (2) various projections by the major

railroads' fuel purchasing officers and others regarding the level of railroad diesel prices during the next quarter.⁴ These quarterly filings reveal that the RCAF methodology takes into account the fluctuation of railroad diesel prices caused by events in the world oil markets. For example, the filing made on December 5, 2005 by the AAR described the damage done by hurricanes Katrina and Rita as largely responsible for the rise in the fuel component of the RCAF. Ex Parte 290 (Sub-No. 5) (2006-1), *Quarterly Rail Cost Adjustment Factor* AAR forecast, Appendix B (page 1), (filed Dec. 5, 2005). These are exactly the same reasons now cited by the railroads in justifying the use of their privately developed fuel surcharges. See, e.g., CSX 2005 Annual Report at 21 and 24.

In adopting the methodology for calculating the RCAF, the ICC stated that "significant problems in the accuracy of fuel data" could warrant a change in the fuel component of the RCAF index. *Railroad Cost Recovery Procedures*, 1 ICC 2d at 218. Thus, there is a standing invitation to all parties to petition the Board for a change in the RCAF if they feel that it does not accurately reflect railroad fuel prices. This action is preferable to the railroads exerting their market power to adopt fuel surcharges that are clearly designed to enhance their overall revenues as opposed to enable the recovery of short term spikes in fuel costs for a particular movement.

3. The Recent Use of the All-Inclusive Index Less Fuel is a Circumvention of the RCAF and a Means to Justify the Use of Separate Fuel Surcharges That Over Recover Fuel Costs.

In recent years, some of the Class I railroads have sought to circumvent the application of the RCAF and the process by which their complaints about it could be rectified by the Board by demanding that their customers accept the AAR's AILF into contracts and common carrier rate quotations, combined with the railroad's tariff fuel surcharge. Under this scenario, justification

⁴ See generally "Rail Cost Adjustment Factor," a publication from the Association of American Railroads (November 2001).

for applying the fuel surcharge is based on the rationale that the AILF does not contain a fuel component, so no double count of fuel costs occurs as would be the case if the RCAF applied. AES has not been exempted from this practice. Unlike the RCAF, however, the AILF has not been formally approved by the Board, meaning the railroads, through the AAR, can change the index without seeking the Board's permission. Moreover, under this scenario, the "fuel surcharges" published by the railroads are not true "surcharges" for the purpose of recovering fuel cost spikes, but rather a separately established mechanism to purportedly reimburse the railroads for any increases (but not refund the shipper for decreases) in the railroads' fuel costs. AES maintains that if a tariff fuel surcharge formula is to be used as a surrogate for fuel cost recovery under the RCAF, then it must be based on a realistic and accurate unit price for fuel and be based on the volume of fuel used for a particular movement. In addition, such a mechanism should not only work one way; to the extent the railroads actual cost of fuel is below the unit price in the formula over the period it is used due to hedging or other factors, then the shipper should receive the benefit of this reduction through rate reductions or credits. However, as shown below, the actual formulas used in the current individual surcharges and their low thresholds for application virtually guarantee the railroads will receive additional revenue from the movement under the auspices of fuel cost recovery even if the cost of fuel for the movement does not increase over the term of the movement.

B. The Lawfulness of Railroad Fuel Surcharges Should be Reviewed Pursuant to the Board's Authority under 49 USC § 10702(2) Governing Unreasonable Practices.

1. Clarification from the Board is Needed

While the ICC decisions referenced above discuss the ICC's treatment of fuel surcharges, there is no clear Board precedent on this particular subject. Specifically, there is no precedent stating definitively whether the Board considers a fuel surcharge to be part of the rate for

transportation or a “rule” or charge whose reasonableness can be challenged independent of the transportation rate. This lack of clear guidance is evident from filings in recent cases. For example, in STB Docket 42072, *Carolina Power & Light v. Norfolk Southern Railway Company*, the parties disagreed over whether NS could assess a fuel surcharge on top of a maximum reasonable rate prescribed by the Board in a case brought under the *Coal Rate Guidelines Nationwide*, 1 ICC 2d 520 (1985). While CP&L had claimed that a fuel surcharge was inappropriate because all fuel costs had already been incorporated into the stand-alone cost (“SAC”) analysis and prescribed rates over the DCF period, NS claimed the surcharge was a separate “rule” that had not been separately challenged by CP&L and, therefore, was not at issue in the case. CP&L Statement of Position at 8-9 (filed June 4, 2004); NS Statement of Position at 2 (filed June 4, 2004). The Board did not resolve this question in *CP&L*. Docket No. 42072, *CP&L v. NS*, at 6 (served Oct. 20, 2004). The same general question has been posed to the STB in other SAC cases, but no answers have been provided. See, e.g., *Western Fuels Association v. Burlington Northern Santa Fe Railway Company*, Docket 42088 (complaint filed October 1, 2004); *Kansas City Power & Light Company v. Union Pacific Railroad*, Docket No. 42095 (complaint filed October 12, 2005). AES believes that the lack of Board guidance on fuel surcharges is one reason shippers have not formally challenged fuel surcharges outside of the SAC context.

2. The Assessment of Fuel Surcharges is a Railroad Practice Subject to the Board’s Jurisdiction over Unreasonable Practices.

Under 49 U.S.C. §§ 10702(2) and 10704(a)(1), the Board has authority over railroad practices. If a railroad practice is found to be unreasonable, the Board can order the railroad to cease engaging in it or the Board can prescribe the “practice to be followed.” 49 U.S.C. § 10704(a)(1). Whether or not a particular railroad practice is unreasonable requires the Board to

engage in a "fact-specific inquiry" to be conducted on a "case-by-case" basis. *WTL Rail Corporation – Petition for Declaratory Order and Interim Relief*, Docket No. 42092 at 6 (served February 17, 2006).

The fact that a railroad's public fuel surcharge is incorporated by reference into a transportation contract should be irrelevant for the purposes of this proceeding. Specifically, in AES's experience, the incorporation by reference of a carrier's "public" fuel surcharges into a new contract is typically made with no modifications, over the strong objection of the shipper, and such inclusion is mandated on a "take it or leave it basis." For this reason, the Board's determination of whether an individual railroad's publicly implemented tariff fuel surcharge is improper should be made by utilizing cost and revenue data from contract movements, consistent with any confidentiality provisions contained in the contracts.

In any event, surcharges are universal rules or charges subject to Board jurisdiction as "transportation-related" practices such as demurrage. STB Docket No. 42068, *Capitol Materials Incorporated – Petition for Declaratory Order – Certain Rates and Practices of Norfolk Southern Railway Company*, at 2 (served April 12, 2004). The manner in which the railroads calculate and assess their individual fuel surcharges is subject to a determination of reasonableness under 49 U.S.C. § 10702(2). In order to ensure that railroad practices are reasonable, the Board has previously used its authority under 49 U.S.C. § 10702(2) to assert jurisdiction over various other railroad rules and surcharges. The Board has evaluated the specific demurrage charges assessed against a shipper under the unreasonable practice standard. *Capitol Materials* at 6. The Board has found a light-density line surcharge to be an unreasonable practice when used in conjunction with contract service. STB Docket No. 42031, *Parrish & Heimbecker, Inc. – Petition for Declaratory Order* at 10 (served May 26, 2000). The Board has

begun a proceeding to evaluate whether BNSF's imposition of storage and demurrage charges on all types of empty private cars awaiting loading is an unreasonable practice. STB Docket No. 42060 (Sub-No. 1), *North America Freight Car Association – Protest and Petition for Investigation – Tariff Publications of the Burlington Northern and Santa Fe Railway Company*, at 9 (served August 13, 2004). The Board has also evaluated whether it was unreasonable for a railroad to limit the hours its track could be used by a second railroad under a trackage rights agreement. STB Docket No. 42083 *Granite State Concrete Co., Inc. and Milford-Bennington Railroad Company, Inc. v. Boston and Maine Corporation and Springfield Terminal Railway Company*, at 1 (served September 24, 2004).

3. Shippers Should be able to Challenge Specific Fuel Surcharges without Using the Board's Rate Reasonableness Procedures.

As Section II.B.1 shows, the Board can evaluate the Class I railroads' general fuel surcharges under the unreasonable practice standard of 49 U.S.C. § 10702(2). There is no need to evaluate a specific fuel surcharge level only in conjunction with assessing the reasonableness of the rate for transportation. As an initial matter, such a requirement would insulate surcharges on rates to dual-served locations from any regulatory scrutiny, since current law would dictate that the Board has no jurisdiction due to a lack of market dominance. 49 U.S.C. § 10707. Moreover, requiring a captive coal shipper to file a rate case under the *Coal Rate Guidelines* to challenge whether a railroad's fuel surcharge is reasonable would also virtually insulate such surcharges from Board scrutiny. AES believes Board's current rate reasonableness standards and procedures present coal shippers with very few opportunities for meaningful relief from railroad monopoly pricing practices, and that this has provided the railroads with considerable leverage over the rates and other terms for transportation to captive facilities as contracts come up for renewal. Accordingly, railroads are able to use the spectre of extraordinarily high

common carrier rates and the high cost, commitment of resources and uncertainty of a rate complaint case to force their captive customers to incorporate the tariff fuel surcharges by reference into a new transportation contract that also contains significant base rate increases. Once the contract is signed, the shipper's ability to object to the fuel surcharge becomes severely limited due to the fact that the Board does not have jurisdiction over rail transportation contracts. In short, a shipper must either pursue difficult contract claims, such as a claim that the inclusion of the surcharge is an unlawful "contract of adhesion," or agreed to under duress, or hope either (1) that the railroad unilaterally reduces the fuel surcharge and that the successor surcharge applies to the contract service, or (2) that an action by the STB requires the railroad to reduce or eliminate the surcharge and that this action also applies to the contract service.

In any event, a fuel surcharge is a universally applicable tariff item that exists independently of the rate. As the Board recognized in the Notice, whether a fuel surcharge is a reasonable practice can be determined by examining whether a mechanism developed by the individual railroad for the stated purpose of recovering fuel cost increases that are not recovered by other means "fairly reflect[s] the increasing fuel costs of the particular movements to which [it is] applied." Notice at 2. There is no need for a stand-alone cost or other rate analysis to make this determination. For example, the Board has previously determined the reasonableness of a particular demurrage charge without resort to rate reasonableness standards. *Capitol Materials* at 4 (finding a \$60 per day demurrage charge to be reasonable without resort to the rate reasonableness standards). The determination of whether a purported fuel surcharge fulfills its cost recovery purpose can be aided by the submission of fuel cost and revenue data by the railroad(s) seeking to assess the fuel surcharge.

III. THE FUEL SURCHARGES IMPOSED BY THE RAILROADS PROVIDING COAL TRANSPORTATION SERVICE TO AES ARE ALL UNREASONABLE PRACTICES BECAUSE THEY PROVIDE EACH RAILROAD WITH REVENUES THAT GREATLY EXCEED THE FUEL COSTS FOR AES'S TRANSPORTATION

The fuel surcharges implemented by NS, CSXT, and BNSF are substantially similar conceptually and accordingly each has substantially the same deficiencies. These can be summarized as follows:

1. The surcharges do not measure actual fuel cost changes.
2. The surcharges ignore the fact that the railroads' current cost of fuel is included in the rate for transportation, so there is no need to apply the surcharge on top of the rate.
3. To the extent the RCAF-U is used to adjust transportation rate levels, the surcharge is unnecessary and overcompensates the railroad for increased fuel costs.

A. The Surcharges do not Track the Railroads' Actual Fuel Costs

The consistent rationale for the current standard fuel surcharges instituted by the Class I railroads serving AES's facilities is that they are necessary to counteract the price volatility in the diesel fuel market. NS has stated that its fuel surcharge allows NS to adjust rail rates when diesel fuel prices change, allowing NS to "more accurately reflect the actual costs of service."⁵ Moreover, according to NS, "the fuel surcharge rule established in the NS Conditions of Carriage is intended to reflect temporary spikes in the price of one specific input, diesel fuel....the fuel surcharge rule applies only as long as the benchmark fuel price exceeds the stated level, and is eliminated as soon as fuel prices return to normal levels."⁶ (emphasis added). NS further stated

⁵ STB Docket No. 42072, *Carolina Power and Light Company v. Norfolk Southern Railway Company*, Defendant Norfolk Southern Railway Company's Statement of Position Regarding Fuel Surcharges, at 1 (filed June 4, 2004) citing STB Finance Docket No. 33388 (Sub. No. 90), *CSX Corporation and CSX Transportation, Inc. Norfolk Southern Corporation and Norfolk Southern Railway Company—Control and Operating Leases/Agreements—Conrail Inc. and Consolidated Rail Corporation*, Decision No. 7 at 5 (n.12), 8 (n.16) (served December 17, 2001).

⁶ *Id.* at 9.

that “[t]his fuel surcharge is not movement-specific, but is rather a system-wide cost recovery mechanism intended to address short-term diesel market fluctuations.”⁷

NS’s justifications are echoed by BNSF:

“[T]he reason that BNSF implemented a fuel surcharge in the first place was the unpredictability of fuel prices. For that reason, BNSF implemented a retroactive mechanism for the fuel surcharge in its common carrier pricing authorities and contracts. BNSF has concluded that the best way to reflect the effect of the fuel surcharge...is to use a comparable index forecast for both operating costs affected by fuel price changes and projected revenues to compensate for those changes. In this way, revenues and costs will change on parallel tracks, which is the basic concept underlying the fuel surcharge.”⁸

1. Rate Multiplier Methodologies

The surcharges of the Class I railroads that transport AES’s coal are calculated pursuant to two general methods that entail applying a percentage increase to the transportation rate (BNSF also has a mileage based fuel surcharge, as discussed below). Neither of these methods measures the individual railroad’s actual fuel costs or reimburses the railroads solely for short term spikes in the cost of diesel fuel for transporting AES’s coal. The first method is to assess a revenue-based fuel surcharge on each shipment when the average monthly price of West Texas Intermediate Crude Oil (“WTI”), based on daily prices published in the Wall Street Journal, exceeds a certain threshold. As examples, this threshold is currently \$23.00 per barrel in Condition 55.4 – Fuel Surcharge (W) of NS’s Conditions of Carriage #2F (applicable to coal, coke and iron ore). On April 24, 2006, NS announced that it intended to “revise its fuel surcharge program for local and joint-line non-intermodal traffic originating and moving on Norfolk Southern-issued tariff and public quotes issued on or after July 1, 2006.”⁹ Such revisions would have no effect on AES. The WTI threshold in CSXT’s tariff CSXT 8200, Item

⁷ STB Docket No. 42072, *Carolina Power and Light Company v. Norfolk Southern Railway Company*, Defendant Norfolk Southern Railway Company’s Statement of Position Regarding Fuel Surcharges, at 3-4 (filed June 4, 2004).

⁸ STB Docket No. 42088, *Western Fuels Assoc. Inc. and Basin Elec. Coop. Inc., v. BNSF Railway Co.*, Reply Evidence and Argument, p. III.A-28 and 29 (filed July 20, 2005).

⁹ The announced revisions include rebasing the WTI average price threshold to \$64.

12000-A is also \$23.00 per barrel. Once the threshold is reached, the current rate for transportation is multiplied by a percentage triggered by the WTI average. Again using NS Condition 55.4 as an example, the fuel surcharge is 0.4% of the line-haul freight charge for every \$1.00 per barrel or portion thereof, that the WTI exceeds \$23.00. Each surcharge using the WTI methodology utilizes this same general approach.

The other primary methodology for calculating fuel surcharges is exemplified by Item 3380 of BNSF rules book 6100, which imposes a revenue-based fuel surcharge on individual coal shipments pursuant to a formula based on the U.S. Average Price of Retail On-Highway Diesel Fuel ("HDF") when the HDF equals or exceeds \$1.24 per gallon. For example, when the Time Period's Average Price of HDF is between \$1.96 and \$1.999 the applicable surcharge rate would be 9.5% of the total freight charges. BNSF specifies the Applicable Fuel Surcharge rate for HDF up to \$3.039 per gallon; when the U.S. National Average Fuel Index exceeds \$3.039 per gallon, the fuel surcharge rate will increase by 0.5% for every \$0.04 per gallon increase. BNSF provides the example of a fuel surcharge applied to shipments during the month of July. This example assumes the prior time period's (May) average monthly price of HDF was \$1.338 per gallon, therefore calculating the July's fuel surcharge as 1.5%. "Thus, for each \$10.00 of freight charges applicable to a shipment, the Fuel Surcharge would be \$0.15." *Id.*

Both of these methods are flawed on their face because they do not measure actual fuel costs but merely apply a multiplier to the transportation rate. Therefore, they bear no relation to the amount or cost of fuel used for the movement being assessed the charge. Clearly, if there is no evaluation of the amount or cost of fuel used, then the surcharge is not "used only to recover the increased cost of fuel for the particular movements to which the surcharge is applied." Notice at 2. Moreover, railroads do not pay highway retail prices for railroad diesel or pay WTI

crude oil prices. Railroads consume huge quantities of railroad diesel fuel annually, can be expected to get volume discounts, and often engage in price hedging activities. To the extent a railroad engages in fuel hedging, a revenue-based surcharge overcompensates the railroad for fuel cost spikes and becomes a revenue generator. *See Fuel Hedge and Surcharge Impacts: Not all Rails Created Equally*, Citigroup, Smith Barney, Airfreight and Surface Transportation, Jan. 5, 2005, at 1. ("Norfolk Southern experienced a substantive boost or tailwind to last year's results through a combination of its extremely effective fuel hedge combined with a very robust approach to fuel surcharge usage. Illustrating our point, we estimate that roughly 20-30% of 2004's earnings growth at Norfolk Southern has been driven by fuel surcharge revenues above fuel expense variances at the operations."). Additionally, BNSF and CSX reported \$328 million and \$249 million of fuel hedging benefit, respectively in 2005. *See BNSF 2005 Annual Report* at 58; *CSXT 2005 Annual Report* at 15.

These methods are also flawed because they do not factor in distance. For example, the actual fuel cost incurred by the railroad for two shipments of equal distance may actually be the same, but the shipper with the higher rate will pay a higher fuel surcharge. Accordingly, two shippers may both be 1000 miles away from the origin mine and have identical operating characteristics, but if one of the shipper's rate is \$15 and the other's is \$10, and assuming a 10% fuel surcharge multiplier, the first shipper will pay surcharges of \$1.50 per ton while the second will pay only \$1.00 per ton.

To the extent that the formula used in a railroad surcharge utilizes a fuel-cost threshold that is lower than the relevant fuel-cost index, e.g., a threshold of \$23 per barrel of WTI when the actual cost per barrel is in the \$60-plus range, the railroads' profits will increase out of proportion to the increase in actual fuel costs. For example, under Condition 55.4, a fuel surcharge is

imposed on coal shippers when the WTI average is above \$23.00 per barrel. According to NS, this price is a "normal level" of fuel price that would cause its surcharge to be eliminated. However, according to the EIA, the WTI annual average price per barrel has been over \$23.00 for every year this decade.¹⁰ This very low threshold virtually ensures that a rate multiplier will be assessed indefinitely, even though NS has recovered its actual cost of fuel through application of the RCAF or other rate adjustment provisions with a fuel component, or through rate increases that reflect, in part, increases in NS's cost of service. The WTI monthly average price per barrel for March 2006 as published in the Wall Street Journal was \$62.90.¹¹ This means that the March 2006 WTI price was \$39.90 over the Condition 55.4 threshold. The May 2006 fuel surcharge multiplier imposed on coal shippers under the Condition 55.4 formula (*i.e.*, based on the March 2006 WTI) increases the transportation rate by 16.0%, even if that rate was implemented on January 1, 2006. Between January 2006 and March 2006, the WTI monthly average price decreased by 4%.¹²

Surcharges using the HDF produce a similar result. For example BNSF's item 3380 is applied when the HDF monthly average, as opposed to the average fuel costs actually paid by BNSF, equals or exceeds \$1.24 per gallon.¹³ However, the HDF has not been at or below that level since March, 2002.¹⁴ BNSF buys diesel fuel in bulk and pays wholesale prices, not retail prices for its fuel.¹⁵ The HDF is not an accurate estimate of the price BNSF pays for fuel. BNSF's actual fuel costs rarely match the HDF price, nor is the change in prices paid by BNSF reflected in the change in the HDF. For example, BNSF's average cost for diesel fuel in 3rd

¹⁰ See EIA website: <http://tonto.eia.doe.gov/dnav/pet/hist/ddroolm.htm>

¹¹ See NS's website www.nscorp.com.

¹² March WTI of \$62.90 per barrel + January WTI of \$65.51 per barrel.

¹³ *Id.*, U. S. Department of Energy's, EIA Retail On-Highway Diesel Prices Report, whose weekly average price is available on their WebPages at: <http://www.eia.doe.gov> is used to determine the mileage-based fuel surcharge.

¹⁴ See <http://tonto.eia.doe.gov/oog/ftp/area/wogirs/xls/psw/8vwall.xls>.

¹⁵ STB Docket No. 42088, *Western Fuels v. BNSF*, Western Fuels Rebuttal Exhibit III-A-3, Pg. 1.

Quarter 2003 was \$0.864 per gallon and its average cost of diesel fuel for 3rd Quarter 2004 was \$0.988 per gallon.¹⁶ BNSF's cost of fuel increased 14.4% from 3rd Quarter 2003 to 2004, whereas the HDF 3rd Quarter 2003 price was \$1.46 per gallon and \$1.83 per gallon in 3rd Quarter 2004, amounting to a 25.3% increase. Therefore, due to the greater increase of the HDF, BNSF shippers paid nearly 11% more than the actual price BNSF paid for fuel from 3rd Quarter 2003 to 2004 because Item 3380 is tied to the HDF threshold, not actual fuel costs.

2. BNSF's Mileage Based Fuel Surcharge

Beginning on January 1, 2006, BNSF adopted a fuel surcharge on certain agricultural and coal traffic that is assessed by multiplying the fuel surcharge amount per mile times the number of loaded car-miles per shipment.¹⁷ The mileage-based fuel surcharge is also determined by using a higher HDF threshold of \$1.25 per gallon compared to the HDF threshold of \$1.24 per gallon used in Item 3380. "Mileage calculations will be based on BNSF Railway Miles between shipments' billed origin and destination as published in BNSF web page: *BNSF Coal Unit Train and Trainload Mileage Table*."¹⁸ According to BNSF, a fuel surcharge based on percentage of revenue has and will continue to create significant disparities between the fuel surcharge assessed and the actual incremental fuel costs.¹⁹ The mileage-based fuel surcharge program is BNSF's attempt to "better align the fuel surcharge assessed...with the actual incremental fuel cost of transporting...goods."²⁰ Distance may be a better proxy for the amount of fuel used in a movement than the transportation rate, but it still is unnecessarily imprecise. The use of distance ignores a variety of factors that affect fuel usage, such as topography, train weight, train speed,

¹⁶ See BNSF Investors Reports available at www.bnsf.com.

¹⁷ Coal Mileage-Based Fuel Surcharge: http://www.bnsf.com/tools/prices/fuelsurcharge/pdf/coal_mileage.pdf

¹⁸ The BNSF Railway Miles is the calculation of miles a carload is transported in the loaded direction. This calculation can be performed in the BNSF website. Also, see BNSF Coal Unit Train and Trainload Mileage Table as attachment.

¹⁹ Frequently asked questions: BNSF Mileage Based Surcharge
(<http://www.bnsf.com/tools/prices/fuelsurcharge/faqs.html>)

²⁰ *Id.*

frequency of stops, and the time required for the movement. The mileage-based surcharge also suffers from the same basic deficiency as Item 3380 in that it uses as a baseline a fuel price that (a) has no relation to BNSF's actual fuel costs; and (b) is not reflective of the current cost of diesel fuel, thereby guaranteeing the surcharge will be assessed.

These fuel surcharge practices therefore do much more than provide recovery of fuel costs during temporary price spikes. They provide significant additional revenue to the railroads.

B. Fuel Surcharges Ignore the Fact that the Current Cost of Fuel is Already Factored Into New Rates.

As stated above, the application of the railroad's fuel surcharges to new transportation rates is particularly problematic because, when a new transportation contract is executed, it must be presumed the railroad's current price of fuel is factored into the new transportation rate. To the extent that either actual fuel costs do not subsequently "spike" or fuel cost increases are covered by a rate adjustment provision with a fuel component, there is no justification for assessing the fuel surcharge multiplier to the transportation rate because the rate will reimburse the railroad for all of the fuel costs it incurs to provide the issue transportation.

C. Application of the RCAF or another Index with a Fuel Component Obviates the Need for Fuel Surcharges

To the extent a railroad fuel surcharge is combined with the use of the RCAF, this is clearly an unreasonable practice because the ICC clearly established that upon adoption of the RCAF, "[m]aintaining a separate surcharge mechanism for fuel would, in our view, serve no useful purpose once these rules are in place, and would, in fact, only complicate the operation of the new system." 364 ICC at 852. As explained above in Section II, the RCAF contains a fuel component. Accordingly, application of any fuel surcharge in conjunction with the RCAF, let

alone the current revenue-enhancing fuel surcharges, results in an additional over recovery of fuel costs for each affected movement.

IV. STANDARDS FOR FUEL SURCHARGES MUST BE ACCOMPANIED BY IMPROVEMENTS IN RATE CASE PROCESSES AND RULES

As stated above, the current fuel surcharge practices of the Class I railroads directly result from the extraordinarily high level of market power they have achieved. They also result from the ineffectiveness, perceived or real, of the STB's maximum reasonable rate procedures and standards to provide any semblance of a meaningful regulatory constraint on such behavior. AES shares the view of many shippers that the Board's recent decisions in coal rate reasonableness cases have thrown into doubt the ability of all but a very small group of rail shippers on very high density sections of a railroad's system to obtain any relief for railroad monopoly pricing. This perception of futility is reinforced by the extraordinary cost of pursuing a complaint case to conclusion and the uncertainty of whether standards applied in one case will be applied in another case, as well as the time it takes to reach a decision. AES is concerned that Board action that results in the reduction of Class I railroad fuel surcharges may in turn result in the railroads simply shifting that revenue source from a "surcharge" to increases in the rates for transportation offered during a contract negotiation or established via common carrier pricing authority. Unless the Board's rate reasonableness standards and procedures provide relief for such increases in transportation rates, then the Board's salutary efforts to review the appropriateness of the railroads' fuel surcharge practices will be undermined. AES is aware of the fact that the Board has commenced a rulemaking in Ex Parte No. 657 (Sub No. 1) to examine certain aspects of the Board's "stand alone cost" means of testing the reasonableness of rail rates. However, AES submits a broader and deeper review of the STB's rate setting policies and standards is required to improve the current state of affairs.

V. THE BOARD SHOULD REQUIRE THE SUBMISSION OF REVENUE AND COST DATA JUSTIFYING THE IMPOSITION RAILROAD FUEL SURCHARGES

To the extent the Board believes that neither current railroad reporting requirements nor data received in this proceeding enable it to determine whether a particular fuel surcharge provides a railroad with more revenue than it needs to recover its fuel costs for a particular movement, the STB should adopt procedures to govern the submission of the additional data necessary. The STB has clear authority to obtain the data it needs under 49 U.S.C. § 721(b).²¹ Railroads already provide certain fuel cost data to the AAR on a quarterly basis through the RCAF process. 49 U.S.C. § 10708.²² In addition, the Board also requires railroads to submit certain cost and revenue data under 49 CFR Parts 1200 through 1300. Furthermore, railroads are required to report certain information regarding carrier rates and service terms pursuant to 49 CFR Parts 1300 through 1332. AES asserts that the data requirements should include information on revenues from fuel surcharges under contracts, since in nearly all cases the contract incorporates the public fuel surcharge by reference without any modifications. Thus, AES believes the Board has the requisite power to use existing regulations or add regulations to obtain any additional information needed to substantiate that "railroad fuel surcharges are being set in such a manner as to insure that they are used only to recover the increased cost of fuel for the particular movements to which the surcharge is applied." Notice at 2.

²¹ 49 U.S.C. § 721 (b) (2006). "Inquiries, Reports, and Orders. - The Board may - (1) inquire into and report on the management of the business of carriers providing transportation and services subject to subtitle IV; (2) inquire into and report on the management of the business of a person controlling, controlled by, or under common control with those carriers to the extent that the business of that person is related to the management of the business of that carrier; (3) obtain from those carriers and persons information the Board decides is necessary to carry out subtitle IV; and (4) when necessary to prevent irreparable harm, issue an appropriate order without regard to subchapter II of chapter 5 of title 5."

²² 49 U.S.C. § 10708 (a) (2006). "Rail cost adjustment factor: (a) The Board shall, as often as practicable, but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Board, with appropriate adjustments to reflect the change in composition of railroad costs, including the quality and mix of material and labor)...."

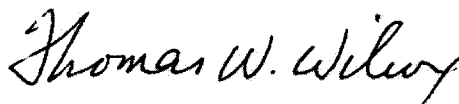
Finally, high fuel surcharges coupled with increasingly poor service have caused public confidence in the rail system to deteriorate. Rail transportation has become increasingly vital to shippers, particularly coal shippers. Rail service failures and reliability problems have hindered utilities' coal supplies. A mild winter and utility coal conservation measures have averted coal inventory problems thus far. However, rail service needs improvement in order to return coal stockpiles to acceptable levels. One part of restoring public confidence in railroad service and reliability is for the railroads to actively participate with the Board and shippers to alleviate the fuel surcharge discrepancy.

VI. CONCLUSION

AES applauds the Board for taking action on the fuel surcharge issue and holding a public hearing. The Board must now take definitive steps to rectify the problem. The Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate under the Board's authority to regulate railroad practices; (2) clarify that railroad fuel surcharges may only be used for the purpose of recovering actual costs of fuel expended for a particular shipper's transportation that are not recouped by other means (3) take appropriate action to correct the current publicly published railroad fuel surcharges of BNSF, NS, CSX, and other similarly imposed railroad surcharges to the extent they do not comport with the above standard; and (4) require each railroad to submit

detailed data reflecting their actual cost of fuel and the revenues associated with fuel cost recovery for each movement to which the fuel surcharge is assessed.

Respectfully submitted,



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