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Before the U.S. Surface Transportation Board

STB Ex Parte No. 661 (Sub-No. 2)

RAIL FUEL SURCHARGES (SAFE HARBOR)

Comments of

National Grain and Feed Association

August 4, 2014

The National Grain and Feed Association ("NGFA") appreciates the opportunity to submit this statement in response to the advance notice of proposed rulemaking issued on May 29, 2014 by the Surface Transportation Board ("Board") requesting comments on whether the so-called "safe harbor" provision of the Board's rail fuel surcharge rules should be modified or removed.

The NGFA, established in 1896, consists of more than 1,050 grain, feed, processing, exporting and other grain-related companies that operate more than 7,000 facilities and handle more than 70 percent of all U.S. grains and oilseeds. Its membership includes grain elevators; feed and feed ingredient manufacturers; biofuels companies; grain and oilseed processors and millers; exporters; livestock and poultry integrators; and associated firms that provide goods and services to the nation's grain, feed and processing industry. The NGFA also consists of 26 affiliated State and Regional Grain and Feed Associations, has a joint operating and services agreement with the North American Export Grain Association, and has a strategic alliance with the Pet Food Institute.

NGFA-member companies are major users of the nation's rail system. Rail carriers hauled approximately 28 percent of all commercial movements of U.S. whole grains and oilseeds in 2011, the most recent year for which data are available. While that was down significantly from the 50 percent share hauled by rail at the time of enactment of the Staggers Rail Act of 1980, rail still represents a significant modal share for major agricultural commodities. U.S. Class I railroad revenues for STCC 01 Farm Products and STCC 20 Food Products equaled $10.54 billion and $10.60 billion in 2011 and 2012, respectively. This represented 16.1 percent of Class I railroad revenues in 2011 and 15.5 percent of the revenues in 2012.

Rail also is the only viable transportation mode available to many agricultural producers and shippers. For example, nearly all the grains and oilseeds grown in Montana, more than 70 percent of the commodities produced in North Dakota, and more than half of the agricultural commodities raised in Arizona, Oklahoma and South Dakota are transported by railroad.[1] In addition, an average of 72 percent of U.S. wheat moved to domestic and export markets by rail from 2007 to 2011, as did an average 56 percent of U.S barley. For total corn movements during the same five-year period, a still-significant 26 percent moved by rail (compared to 11 percent by barge and 63 percent by truck), while 24 percent of all U.S. soybeans moved by rail (compared to 20 percent by barge and 55 percent by truck).[2]

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[1] *Study of Rural Transportation Issues*, U.S. Department of Agriculture and U.S. Department of Transportation (April 2010).
[2] *Transportation of U.S. Grains, A Modal Share Analysis*, 1978-2011 Update, U.S. Department of Agriculture Agricultural Marketing Service (May 2013).

Thus, this proceeding is of great importance to shippers of grains, oilseeds and processed agricultural products derived therefrom.

During the time span since fuel surcharges began to be assessed separately by the railroads in lieu of recovering incremental fuel costs – fuel costs not recovered by the base transportation rate – as part of an overall rate adjustment mechanism in 2001, carriers have reduced their fuel costs by enhancing the efficiency of rail operations. For example: 1) new, more fuel-efficient technology has been adopted, including the use of more fuel-efficient locomotives; 2) heaters have been added to locomotives so they can run for extended periods of time; 3) outdated equipment has been retired or retrofitted; 4) fewer locomotives, in some cases, now are used per trainload than in the past; and 5) train crews, in some cases, have been incentivized to identify fuel savings and/or reprimanded for inefficient operating practices that increased fuel consumption. Each of these actions by rail carriers has been aimed at reducing fuel consumption and costs.

There also have been continuing changes rail shipping patterns that have enhanced fuel efficiency and reduced fuel costs for carriers that have not been reflected in fuel surcharges. For example, fuel costs differ between unit train shipments – which are increasingly prevalent – versus single-car manifest traffic that is switched several times prior to reaching final destination. Yet for many agricultural commodities the fuel surcharge per car is identical regardless of whether the shipment involves unit trains or single cars. That differs from the practice implemented for PRB coal and other formulas that arguably account for the efficiency of unit-train movements for that commodity.

Some of these enhancements to fuel efficiency no doubt have required investments in technology and equipment by carriers that they have a right to recoup. However, these monetary rewards for railroads should not be borne in perpetuity by shippers paying higher-than-justified fuel surcharges or excessive fuel costs imbedded in the underlying freight rate. It also should be e emphasized that since the implementation of separate fuel surcharges shippers also have invested, and continue to invest, significant capital to improve load-out and receiving capacity, which has enabled carriers to reap the benefits of more fuel-efficient movements and other efficiencies. Thus, shippers, too, should benefit from reduced carrier expenses for fuel through reduced rail rates and fuel surcharges.

Finally, the rail industry – which likely constitutes the second or third largest user of fuel in North America – undoubtedly has benefitted from economies of scale in purchasing fuel at price levels that cannot be adequately reflected by relying on a fuel-cost index, such as the Energy Information Administration's Highway Diesel Fuel Index ("HDF Index").

The NGFA previously has commended the Board for its 2007 decision that prohibited rate-based fuel surcharges as an unreasonable practice, and continues to strongly support that decision. In so doing, the Board recognized that rail rates generally are not highly correlated with the fuel expense of individual movements – a natural outgrowth of differential pricing – and that fuel surcharges calculated as a percentage of the base rail rate created significant distortions that resulted in some shippers paying what could only be characterized as punitive assessments. As a consequence, fuel surcharges applicable to virtually identical movements in some cases varied by several hundred dollars per car.

The NGFA's policy position was then – and is now – that it is reasonable for a railroad to recover **<u>unanticipated</u>** increased fuel expenses through a separate "fuel surcharge," provided the surcharge is reasonably related to the increases in market fuel costs that they have incurred over-and-above the fuel costs recovered in the base rate. In that regard, the NGFA has believed that it is reasonable to expect both gains and losses from fuel-hedging activities to be accounted for, and to accrue to the benefit/cost of the carrier. But in its filings with the Board during the proceeding (EP 661) that culminated in the 2007 decision, the NGFA also noted there was a fundamental problem resulting from the lack of transparency by carriers in reporting fuel-cost information that could be used to determine if fuel surcharges fairly reflect cost increases and/or are equitable. The NGFA reiterates that this concern remains every bit as relevant today. We continue to believe that the Board could play a useful and critical role by requiring carriers to provide more information and transparency on fuel-related costs incurred to their customer base. If railroads expect their customers to compensate them for increased fuel costs, they should be willing to provide appropriate documentation to demonstrate they are assessing only those charges that recover actual net fuel costs, and nothing more.

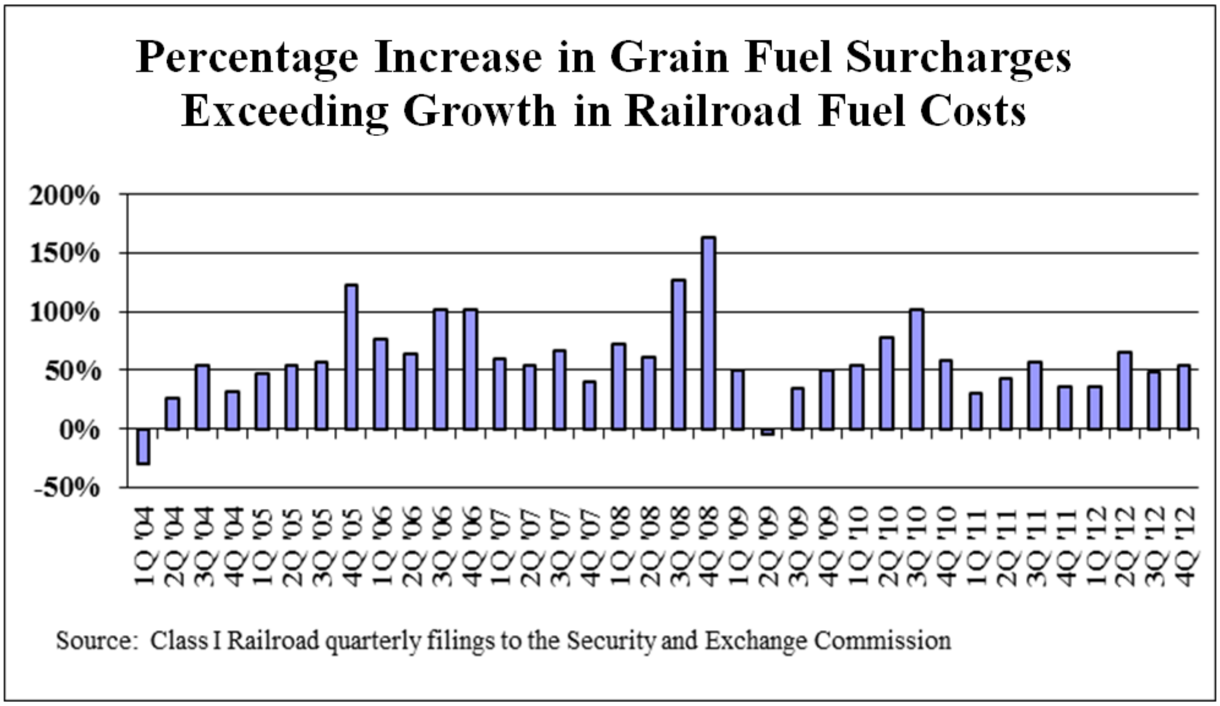
The NGFA believes this proceeding provides an important opportunity for the Board to rectify problems that have arisen as a result of the application of the HDF Index "safe harbor" provision of its fuel surcharge rules, as well as other anomalies. In particular, the NGFA believes it is time to rebalance the initial intent of rail fuel surcharges to compensate carriers for net incremental additional fuel costs actually incurred versus giving "safe harbor" to a specific fuel index or methodology that may not adequately reflect such actual costs, nor account for fuel-efficiency improvements or other factors influencing actual fuel costs incurred by railroads.

In this proceeding, the Board notes that it is revisiting the "safe harbor" provision as a result of a fuel-surcharge complaint brought by a major agricultural shipper against a Class I railroad. The agricultural shipper alleged that the carrier's mileage-based fuel surcharge program constituted an unreasonable practice because it extracted substantial profits on the traffic to which the surcharge was applied. In its decision on this particular challenge, the Board ruled, in effect, that it had no choice but to dismiss the complaint because the carrier had relied upon the "safe harbor" the Board had established for carriers that utilized the HDF Index to measure changes in their fuel costs for purposes of their respective fuel surcharge programs.

In so doing, the Board ruled that it could not examine or rely upon evidence of changes in the rail carrier's actual internal fuel costs, even though upon its own analysis the Board determined that if the carrier's incremental fuel costs had been measured by the railroad's internal fuel costs, the fuel surcharge revenues would have exceeded its incremental fuel costs by $181 million. The Board observed that this occurred because changes in the HDF Index did not precisely reflect changes in BNSF's internal fuel costs. "In particular, the 'spread' – i.e., the overall difference between the average retail price per gallon as reflected in the HDF index and the lower wholesale price per gallon actually paid by BNSF – increased significantly more than it decreased over the five-year analysis period," the Board stated.

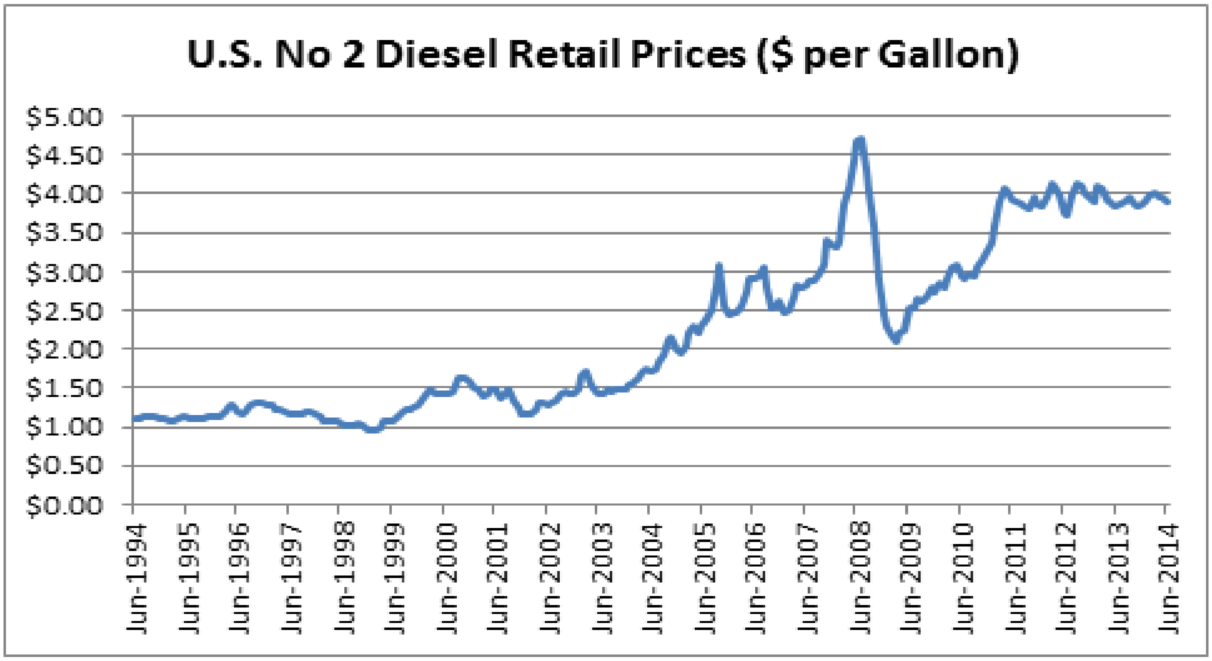
The NGFA appreciates that the Board has expressed concern at this undesirable outcome, and has recognized that in its fuel surcharge decision in 2007, a situation had not been foreseen where the spread between a rail carrier's internal fuel costs and the HDF Index would diverge as it did in the 2013 complaint filed by the major agricultural shipper.

As shown in the chart below, "overcharges" by rail carriers through fuel surcharges are not an isolated occurrence. From the second quarter of 2007 (when the 2007 decision became effective and the HDF Index was implemented as a safe harbor) through the fourth quarter of 2012, the average quarterly growth in fuel surcharges assessed on grain shipments amounted to more than $300 per car, while data reported by carriers to the Securities and Exchange Commission (SEC) over the same time period showed an average growth in fuel costs of less than $200 per car. On average, that translates into a nearly $120-per-car – or 62 percent – increase in rail fuel surcharges over-and-above reported actual rail fuel costs on an industrywide basis for the eight-year period. As indicated in the chart, there were only two quarters during this period when the percentage growth in grain fuel surcharges were less than the growth in railroad fuel costs.



Further, it should be noted that one of the major causative reasons used by carriers to justify rail fuel surcharges when they became a non-negotiable condition of receiving rail service around 2001 – volatile and unpredictable fluctuations in fuel costs – largely has moderated since 2010, as depicted in the following chart of monthly U.S. diesel fuel prices for the past 20 years obtained from the U.S. Energy Information Administration.[3]

[3] EIA does not publish prices specifically for "off-road" diesel fuel, also known as off-highway diesel fuel. Off-road diesel fuel is sold for use in vehicles and equipment that are not general operated on public roadways, such as those used on farms and **railways**, in construction, and for electric power generation. It is not subject to state and federal excise taxes that are applied to the retail sales of diesel fuel sold for vehicles generally operating on public roadways. The latest EIA publication on federal and state diesel fuels taxes is from February 2012, at which time the average federal diesel fuel tax was 18.40 cents per



For these reasons, the NGFA strongly recommends that the STB significantly modify the "safe harbor" provisions of its rail fuel surcharge rules.

Use of the HDF Index Alone is Not an Accurate Barometer of Actual Net Fuel Costs Incurred by Carriers

As documented in the fuel surcharge complaint that triggered this proceeding, reliance upon the HDF Index in-and-of itself does not provide a true picture of the actual net fuel costs incurred by rail carriers. Nor does its use necessarily lead to uniformity in fuel surcharges assessed by carriers, as there is evidence that the Class I carrier whose fuel surcharge was challenged as unreasonable had assessed a considerably higher surcharge than some other Class I carriers.

The NGFA does not argue that the Board eliminate use of the HDF Index as a benchmark for measuring fuel costs. But we do strongly recommend that reliance on the HDF Index by granting it "safe harbor status" should **not** immunize rail carriers from being challenged for setting fuel surcharges at levels that exceed the net incremental fuel costs actually incurred.

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gallon and the average state diesel fuel tax was 23.18 cents per gallon. This chart does not subtract federal and state diesel fuel taxes.

<u>Eliminating or Modifying the Safe Harbor</u>

Alternatively, the NGFA urges the Board to either eliminate the safe harbor or modify its safe harbor rules so as not to immunize rail carriers when they cannot adequately demonstrate to the Board a reasonable nexus between their fuel surcharge formulas and their actual internal incremental fuel costs.

In either case, we believe rail carriers should be required to provide additional information on their actual internal incremental fuel costs to the Board and the public to the extent necessary to adequately demonstrate such a reasonable nexus. The NGFA believes requiring additional information could provide a reasonable check to monitor whether carriers are instituting fuel surcharges that over-recover the actual incremental fuel costs incurred.

The NGFA notes that railroads currently, in their filings of Quarterly Reports of Rail Fuel Surcharges, report the following data: 1) total fuel cost; 2) total gallons of fuel used; 3) total increase or decrease in the cost of fuel; 4) total revenues from fuel charges; and 5) revenue from fuel charges on regulated traffic. NGFA urges the Board to require delineation of each of these data sets by major commodity group (e.g., agricultural products, chemicals, coal, etc.).

Further, the NGFA recommends that the STB require reporting of more granular, specific information by rail carriers within their filings of Quarterly Reports of Rail Fuel Surcharges <u>for each major commodity group</u> (e.g., agricultural products, chemicals, coal, etc.), as follows: 1) total fuel costs already <u>recovered through their respective base-rate structures</u>; 2) the difference between internal fuel costs recovered through base-rate structures and the amount collected through fuel surcharge revenues; and 3) any other relevant information that would limit, if not circumvent, the need to file a complaint under 49 U.S.C. § 10702(2) in order to ascertain whether a fuel surcharge formula that relies on the HDF Index "safe harbor" is enabling the carrier to recover no more than its incremental fuel costs.

The data provided through 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 more transparent than it is today. 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.

Finally, any future use of the HDF Index should be subject to the Board's paramount objective of preventing fuel surcharges from becoming profit centers and sanctioning over-recovery of net incremental additional fuel costs actually incurred by carriers. If the latter occurs, the Board should be empowered to direct railroads to promptly refund overcharges to their rail user customers.

Conclusion

The NGFA reiterates its recommendation that the safe harbor standing currently accorded to the HDF Index be modified significantly so as not to immunize railroads from responsibility and liability if they overcharge rail customers for the incremental fuel costs actually incurred by the carrier. We recommend additional, transparent reporting by carriers in the Quarterly Report of Rail Fuel Surcharges to enable the Board and rail customers to better track whether the objective of preventing unreasonable fuel surcharges is being achieved.

The NGFA appreciates the Board's consideration of the views and recommendations expressed in this statement, and looks forward to being a fully engaged and constructive participant in future discussions with the agency on this important matter.

Sincerely yours,

Randy Gordon

Randall C. Gordon
President