

Feeling The FSC Pain

All shippers, regardless of mode of transportation they use, have felt the pain that arrives regularly in the mail. The letter they receive typically goes something like this:

Dear shipper:

As you are no doubt aware, fuel prices continue to spiral to historical high levels. Our firm has acted in good faith to resist seeking price relief as long as we possibly could. Due to the critical nature of the current situation, we can no longer continue to absorb the increased fuel costs.

Therefore, effective next month, we must implement a temporary fuel surcharge on all shipments. The fuel surcharge will remain independent from our base rates and will be shown as a separate entry on our freight bill. The fuel surcharge amount will reflect the extra cost of the fuel used on a specific trip.

The Law Encyclopedia defines a surcharge as "an additional charge of money made because it was omitted in the original calculation or as a penalty." Regardless of your definition, the fuel surcharge is a burden felt at every level in the transportation marketplace and is now becoming part of an inflation cycle that is having an impact on goods and service of all kinds.

A New Jersey owner of a diner has seen first hand the impact of increased fuel. He recently noticed a small fuel surcharge on his delivery invoices. Now what portion of a truck will a box of straws take up to warrant a \$1.50 added to the cost of a delivery? But when you multiply that by the number of deliveries made in a week you start to see the impact the cost of fuel is having on goods and services.

According to Bill Zollars, CEO of Yellow Roadway "everybody's doing it..." Welcome to the surreal world of fuel-related surcharges. Over the last five years, most long-haul freight companies have begun adopting such fees to cushion the impact of volatile oil prices. "It's the ultimate hedge for us," notes Zollars.

Therein Lies The Rub

Are fuel surcharges a hedge, a fair reimbursement or are they a hidden revenue stream. With high oil prices, it seems anybody who can possibly tack a fuel surcharge onto an invoice does so, creating headaches for those who cannot pass along these costs. Most freight companies calculate fuel surcharges according to fuel indexes such as the U.S. Energy Dept. index that tracks the price of diesel fuel.

The American Trucking Association recently revised upward the trucking industry's 2006 fuel costs; projecting motor carriers will spend \$98.3 billion on fuel in 2006. The revised estimate follows the release in May by the Energy Information Administration of an adjustment in its 2006 forecast of the national annual average price of diesel from \$2.59 per gallon to \$2.70. This will increase the trucking industry's fuel bill by \$4 billion dollars and represents a \$10.6 billion increase over the \$87.7 billion spent for diesel fuel by

motor carriers in 2005.

Based on our truckload analysis we have found that it is typical for a 30% - 40% margin to be factored into the carrier's fuel surcharge. In addition, short haul fuel surcharge should be considered differently than long haul fuel surcharge. Most of the time the surcharge is calculated as a percentage of the shipment cost; however, this would typically result in a higher cost to shippers on short haul movements.

As warned in our previous newsletter, further increases are likely in 2006 because of the introduction of ultra low sulfur diesel. The Environmental Protection Agency set June 1 as the deadline for 80 percent of the on-road diesel fuel refined or imported to begin to use ultra low sulfur diesel. They have until Oct. 15 to fully comply with the ULSD rules. ULSD costs more to refine and distribute than today's diesel fuel. This will place additional upward pressure on the price of diesel fuel.

What Is The Impact?

For most shippers, this process may seem like a heavy penalty that they began to pay when diesel fuel rose above \$1.20 a gallon. If the recent past sets a precedent for the future, there does not seem to be anything temporary about the nature of the fuel charges that are being levied. They have continued to rise on a regular basis as the published price of diesel fuel continued to climb.

Since about 70% of what we produce as a nation travels by truck, we wanted to take a look at how the fuel surcharge is being assessed. We began by looking at 2 TL and 4 LTL carriers and three integrated carriers where you can easily see there are both similarities and variances.

Here is an example of a TL carrier picking up in PA going to CT. The carrier has a \$ 900.00 minimum charge going into New England. The move traveled 198 miles. With diesel fuel at \$2.80, the amount of their surcharge was \$261.00. Using 5.5 mpg for an average truck, this works out to \$7.25 a gallon.

On the LTL side, we looked at Yellow and ABF as of May 24th with diesel fuel at \$2.88 a gallon, added a surcharge of 19.7% on LTL shipments and 39.4% on TL movements. With diesel fuel at \$2.88 a gallon, Watkins applies a fuel surcharge of 18.5% and 25% on TL rated shipments. Overnite Express takes a different position: "Due to the unprecedented rise in fuel prices, and the increase in crude oil by over 21%, Overnite Express' standard fuel surcharge is 14%. Overnite Express consistently supports our position of providing the highest level of service with competitive rates, by continuing to maintain a lower fuel surcharge."

But, when you take a quick look at the three major integrated carriers web sites, fuel surcharges for ground shipments revealed the following:

UPS uses an index-based surcharge that is adjusted monthly. Well, that seems simple enough. But, if you read further, you find that – "Changes to the surcharge will be effective the first Monday of each month and posted approximately two weeks prior to the effective date. For your billing convenience, we will also post a 90-day surcharge history. The surcharge will be based on the National U.S. Average On Highway Diesel Fuel Prices reported by the U.S. Department of Energy for the month that is two months prior to the adjustment. For example the surcharge for January 2006 is based on the November 2005 National U.S. Average Highway Diesel Fuel Price."

FedEx Ground's fuel surcharge effective February 7, 2005, is calculated as follows. The surcharge percentage for FedEx Ground services will be subject to monthly adjustment based on a rounded average of the national U.S. on-highway average price for a gallon of diesel fuel.

Fuel surcharge percentages and associated trigger points are subject to change without notice if the fuel surcharge rises above 5.50% for FedEx Ground or there are changes to the trigger points.

For DHL, their Ground Delivery Service indexed surcharge calculation is linked to the monthly rounded average of the national U.S. on-highway average price for a gallon of diesel fuel as published by the U.S. Department of Energy. DHL applies the monthly rounded average from the period two months prior to calculate the applicable fuel surcharge percentage. For instance, the June 2006 fuel surcharge percentage as calculated by DHL was based on the U.S. on-highway monthly rounded average from April 2006.

Are You Confused?

The administration of fuel surcharges by carriers is confusing to shippers on several levels. First, how do you compare carrier bids, since the fuel surcharge is a variable charge that can be based on different scales and effective dates of increase by each carrier? Second, how does a shipper identify the least cost carrier at the time of shipment? Third, what happens when there are significant changes to the cost of fuel in either direction? Finally, what do you do when you prepay and add the cost of transportation to your customer's bill?

Here Are Some Solutions

Shippers need to be proactive and measure fuel costs before they can begin to control them. Your first goal is to get your carriers on an apples to apples cost basis for fuel. A recent review conducted by Data2Logistics revealed the effective rates of some carrier fuel surcharges was the equivalent of \$5.25 a gallon. We have helped many of our customers establish a corporate wide fuel surcharge schedule that is carrier neutral. Carriers will apply a negotiated fuel surcharge but you must do your homework first.

Our analysis begins by going back to the carrier's base rate which had an embedded cost of fuel built into it of \$1.20 a gallon and then building increases on a consistent basis from that point forward. By going back to the carrier's base rate, we take out the oversized bumps that have grown into carrier fuel charge schedules. We also take into consideration, distance and regions of the country where shipments are made. Once this analysis is completed, you get a clear view of your carrier charges on a level set basis and carriers with excessive rates will be identified.

For those looking to manage to certainty, we have also helped our customers create caps on their fuel surcharges so they know what their worst case scenario would be. It is also important to create a consistent application for the effective date of increases and decreases (yes, there should be a timely reduction when the cost of fuel drops).

Rail Shippers Have Their Say

At the May 11th hearing held by the Surface Transportation Board, many rail shippers complained that railroads were unfairly profiting by imposing unnecessarily high fuel surcharges to offset rising fuel costs. The Surface Transportation Board, a part of the Department of Transportation, oversees rail rate and service disputes. Shippers are asking the board to change how railroads calculate and assess fuel surcharges.

Large rail shippers indicated that they felt (and we agree) that there are flaws in the methodologies that railroads use to calculate the add-on fees.

The National Industrial Transportation League and others testified that all but one Class I railroad assesses a fuel surcharge based on a percent of the transportation rate of each move. Railroads typically set rates based on commodities not mileage. This results in those customers shipping higher priced commodities

If you are a prepay and add shipper, and you are not passing along the fuel surcharge to your customer, you may find that these added costs are quietly eroding your profit margins. Today, shippers that have resisted passing along this added cost of transportation are in a small minority.

There are also fuel hedging programs that we have helped our customers develop. These programs allow you to create a consistent environment within which costs can be controlled and eliminate the need to explain those nasty transportation expense hikes.

To learn more about how Data2Logistics can help you control spiraling fuel surcharges contact Drew Daly (732) 606-7073.

paying a higher fuel cost than those shippers who are charged lower commodity rates; when in reality, the fuel costs are actually the same. One of the greatest points of contention is the need for transparency when it comes to determining the amount that railroads need for incremental fuel costs. There are estimates by the consulting firm Snavelly, King, Majoros, O'Connor & Lee, that the amount of over recovery by railroads could have been as high as \$1 Billion in 2005. STB officials did not give any indication how or when they might respond to the concerns expressed at the hearing.

Freight Feedback

Do you want to exchange ideas and share feedback with your counterparts in other organizations regarding fuel and other transportation topics? Data2Logistics' clients are able to access the Freight Feedback web site at no cost.

Feedback Repository - allows Transportation & Logistics professionals to enter & search feedback on their transportation service providers or their potential service providers. Over time this will be a great resource for professionals when you are deciding to do business with a new transportation or logistics company. You can also rate these providers on their performance.

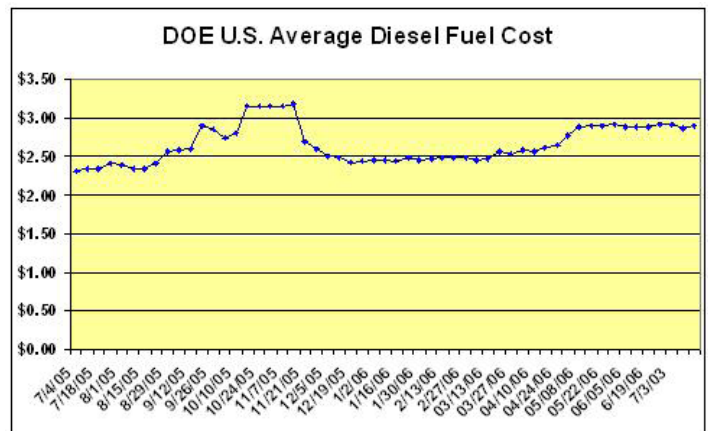
Discussion board - allows Transportation & Logistics professionals to ask each other questions and share knowledge. Some potential examples are:

- An individual has little experience in Mexico or Asia and is looking to move production there, by posting a question another individual with experience can offer some helpful tips.
- A shipper moving a lot of truckloads in one direction & wants to partner with someone moving volume in the opposite direction, can post a question looking to build round trips. Visit this site at <http://www.freightfeedback.com/index.cfm>.

HHG Fuel Costs Going Up

Anyone planning to relocate can expect to pay more this year, too. The surcharge rate suggested by the American Moving & Storage Assn. is 12%, up from about 5% a year ago and setting a new record. The increase can add \$200 or more to the \$2,800 hauling cost for a standard residential move.

Diesel Fuel Cost



Contact Us

If you have any questions, comments or concerns, please go to our web site at www.data2logistics.com or contact Harold Friedman at 609-683-3917 or via e-mail at harold.friedman@data2logistics.com.

