

FARE REVIEW CYCLE 2011

Fuel Cost Mitigation Strategy and the Fuel Surcharge

July-August 2011

AN INTEGRATED FUEL COST MITIGATION STRATEGY

WSF released an Updated Fuel Cost Mitigation Plan in the spring of 2011, which presents an integrated set of strategies to improve WSDOT's budgeting practices and reduce exposure to fuel price volatility. The strategy consists of four tools designed to work together to achieve these goals:

- (1) Improved fuel budgeting and forecasting techniques,
- (2) Fixed price hedging,
- (3) Fuel conservation techniques, and
- (4) A fuel surcharge.

Consistent with the Legislative direction, the fuel surcharge is the strategy of last resort and will only be implemented once the Department has put into practice the other fuel cost mitigation strategies identified in its plan.

2011 COMMISSION PROPOSAL

Summary of Fuel Surcharge Mechanism

The Commission proposes a system-wide, formula-based fuel surcharge mechanism to provide additional funding when fuel costs exceed the amount budgeted for fuel. **Key policies governing the fuel surcharge are:**

- **The Fuel Surcharge is the Strategy of Last Resort.** It will only be used to cover unexpected fuel costs that exceed the amount budgeted for fuel. Improved forecasting techniques and fixed-price hedging will minimize the risk of WSF exceeding its fuel budget. Revenue generated from the fuel surcharge will only be used to offset excess fuel costs.
- **Formula will be run Quarterly.** The need for a fuel surcharge will be reviewed quarterly and if triggered, customers would be notified 30 days before any fare change.
- **Minimum Surcharge Amount of 2.5% of the Applicable Fare.** A fuel surcharge will not be implemented until the calculated surcharge amount is at least 2.5%, which equates to actual fuel costs exceeding the budgeted amount by about 6%. At the current budgeted fuel price of \$3.86/gallon, fuel prices would need to reach \$4.08 before a surcharge of 2.5% would be implemented.
- **Maximum Surcharge Amount of 10.0% of the Applicable Fare.** The implemented surcharge amount will not exceed 10%, even if the formula-calculated amount is higher.

- **Fixed Thresholds.** If the fuel surcharge comes into effect or changes due to rising fuel costs, it will only be changed by fixed increments of 2.5%. Given the minimum and maximum levels, the applicable fuel surcharge amount will be either 2.5%, 5.0%, 7.5%, or 10.0% of the applicable fare.
- **Surcharge Reset to Zero at Each Biennium.** The surcharge amount will be reset to zero as part of the biennial budgeting process.

Example Fare Impacts

Exhibit 1 shows how the fuel surcharge amount is calculated. After the surcharge amount is calculated, it is rounded down to the nearest increment of 2.5% to be implemented at one of the fixed thresholds.

**Exhibit 1
Formula for Calculating Surcharge Amount**

| | | | | | | | |
|---------|--------------------------|--|---|--|---------------------------------|--|----------------------|
| | Excess Fuel Over Budget* | | Fuel Share of Operating Costs (Budget*) | | Farebox Recovery Rate (Budget*) | | Calculated Surcharge |
| EXAMPLE | 10% | | 29% | | 66% | | 4.4% |

* "Budget" refers to the assumptions included in the currently adopted state transportation budget.

Exhibit 2 shows how hypothetical changes in the actual price of fuel would affect the fuel surcharge amount, using current central sound fares as an example.

**Exhibit 2
Hypothetical Fuel Prices and Potential Fuel Surcharge Impacts (Proposed Central Sound Fares)**

\$3.86 Budgeted fuel price per gallon

| Actual Price of Fuel | Pct over Budget | Fuel Surcharge | Calculated Surcharge Amount | Car & Driver Surcharge | Total Car & Driver FF | Passenger Surcharge | Total Passenger FF | Notes |
|----------------------|-----------------|----------------|-----------------------------|------------------------|-----------------------|---------------------|--------------------|--|
| \$3.86 | 0.0% | 0.0% | 0.0% | | \$12.15 | | \$7.10 | Current fare & budget price of fuel |
| \$4.05 | 5.0% | 2.2% | 0.0% | \$0.00 | \$12.15 | \$0.00 | \$7.10 | No surcharge |
| \$4.08 | 5.7% | 2.5% | 2.5% | \$0.30 | \$12.45 | \$0.20 | \$7.30 | Minimum threshold of 2.5% met |
| \$4.15 | 7.5% | 3.3% | 2.5% | \$0.30 | \$12.45 | \$0.20 | \$7.30 | |
| \$4.25 | 10.0% | 4.4% | 2.5% | \$0.30 | \$12.45 | \$0.20 | \$7.30 | |
| \$4.34 | 12.5% | 5.5% | 5.0% | \$0.60 | \$12.75 | \$0.35 | \$7.45 | Increased to 5% level |
| \$4.40 | 14.0% | 6.2% | 5.0% | \$0.60 | \$12.75 | \$0.35 | \$7.45 | |
| \$4.46 | 15.5% | 6.8% | 5.0% | \$0.60 | \$12.75 | \$0.35 | \$7.45 | |
| \$4.52 | 17.0% | 7.5% | 7.5% | \$0.90 | \$13.05 | \$0.55 | \$7.65 | Increased to 7.5% level |
| \$4.59 | 19.0% | 8.3% | 7.5% | \$0.90 | \$13.05 | \$0.55 | \$7.65 | |
| \$4.69 | 21.5% | 9.4% | 7.5% | \$0.90 | \$13.05 | \$0.55 | \$7.65 | |
| \$4.79 | 24.0% | 10.5% | 10.0% | \$1.20 | \$13.35 | \$0.70 | \$7.80 | Capped at 10% limit |

Notes: Table is for illustrative purposes only and is based on **current fares**. Actual surcharge impacts would depend on final adopted rules
 Fares are rounded to the nearest nickel after applying the surcharge amount
 The surcharge amount would be shown separately on receipt
 Actual price of fuel is the overall average price including gallons purchased using fixed price contracts and gallons purchased at spot prices

LEGISLATIVE DIRECTIVES – 2009/11 TRANSPORTATION BUDGET

- **For the WSTC.** If the commission considers implementing a ferry fuel surcharge, it must first submit an analysis and business plan to the office of financial management and either the joint transportation committee or the transportation committees of the legislature (see 2011 report linked below). The commission may impose a ferry fuel surcharge effective July 1, 2011. When implementing a ferry fuel surcharge, the commission must regard ferry fuel surcharges as fare policy changes and thus, ferry fuel surcharges should be included in all public procedures and processes currently used for fare pricing per RCW 47.60.290.
- **For the Department.** If, after the department's review of fares and pricing policies, the department proposes a fuel surcharge, the department must evaluate other cost savings and fuel price stabilization strategies that would be implemented before the imposition of a fuel surcharge. The department shall report to the legislature and transportation commission on its progress of implementing new fuel forecasting and budgeting practices, price hedging contracts for fuel purchases, and fuel conservation strategies by November 30, 2010. (see 2011 report linked below)

AVAILABLE REPORTS ON FUEL SURCHARGE

Fall 2009 - Working with the Transportation Commission, WSF developed a Fuel Cost Mitigation Plan (<http://www.wstc.wa.gov/CommissionLibrary/FerryFuelSurchargeReport.pdf>) that:

- Described WSF's fuel conservation plan.
- Detailed a potential hedging plan that would be aligned with WSF's fuel purchasing and budgeting processes.
- Provided a business plan for how a fuel surcharge might be applied to fares, if necessary.

Spring 2011 – WSF prepared an updated report on the Fuel Cost Mitigation Plan that was released in spring 2011, and presented key findings and recommendations to the Commission and the Legislature (http://www.wstc.wa.gov/Meetings/AgendasMinutes/agendas/2010/December14/documents/20101215_BP12B_FuelCostMitigation.pdf). This update:

- Described in detail how a hedging program could work given WSF's purchasing and budgeting constraints.
- Documented new reporting that would be required.
- Presented several "what-if" scenarios that show what the implications (fuel cost and ferry fares) would have been over the past several years had the hedging and fuel surcharge program been in place during this period of significant price volatility.
- Identified key decision points including how much of the total expected fuel purchases should be locked in at a fixed price and at what points in time should these decisions be made.