



Muscatine Power and Water

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April 26, 2006

Filed Electronically via E-Filing

Honorable Vernon A Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington DC 20423

Re: Ex Parte 661, Rail Fuel Surcharges

Dear Secretary Williams:

Please accept this as a written statement from Muscatine Power and Water relative to the hearing on Rail Fuel Surcharges, May 11, 2006, Ex Parte 661. Muscatine Power and Water does not intend to attend nor participate in testimony at the hearing.

Muscatine Power and Water is a municipal utility located in Muscatine, Iowa. We burn approximately 1.1 million tons of PRB coal annually in our four generating units. With fuel costs being our largest operating expenditure, fuel cost increases have a significant impact on our operations. To assist in controlling these increases, we believe it is imperative that the methodology for application of fuel surcharges be appropriate to insure that they be used only to recover an increased cost of fuel.

We appreciate the opportunity to present our position on this very important matter.

Very truly yours,


Jay D. Logel
General Manager

Attachments: Statement of Position and Exhibit

JDL:crt

**Muscatine Power and Water
Statement of Position
STB Ex Parte No. 661**

Muscatine is a customer-driven, municipal utility, headquartered in Muscatine, Iowa. It is the largest municipal electric utility in Iowa in terms of sales and generation, providing electricity to approximately 10,800 customers. Muscatine owns and operates four coal fired electric generating facilities with a combined capacity of 293.55 MW. All of these facilities are located at the Muscatine Electric Generating Station ("Muscatine") in Muscatine, Iowa.

The Muscatine Station burns approximately 1.1 million tons of coal annually. Currently, Muscatine acquires coal from the Buckskin Mine in the Powder River Basin of Wyoming ("PRB"). The coal moves by rail on the Burlington Northern and Santa Fe Railroad ("BNSF") to Ottumwa, Iowa where BNSF interchanges the coal with the Iowa, Chicago & Eastern Railroad ("ICE") for delivery to the Muscatine Station. Upon expiration of its coal supply and transportation agreements, Muscatine has the option to originate coal at any PRB mine on BNSF or the Union Pacific Railroad ("UP"), or the Dakota Minnesota & Eastern Railroad ("DME") once its proposed build-in to the PRB has been completed.

It is our understanding that the railroad industry implemented their Fuel Surcharge Practice in about 2002 as a fuel cost recovery tool. The basic methodology is the assessment of an additive or *Surcharge* to the Freight Bill transportation charges. The *Surcharge* trigger is either the price per gallon of diesel fuel or barrel of crude oil depending on which rail carrier is utilized. BNSF and UP use the US average price of Retail On-Highway Diesel Fuel ("HDF") as reported on the U.S Department of Energy's

web pages. Muscatine's basic concern is the use of a trigger that is totally unrelated to the actual cost of diesel fuel paid by the railroad utilizing the *Surcharge* practice. The recovery of fuel can occur either through the use of a rate adjustment mechanism or a fuel surcharge. Muscatine understands the railroads implemented the *Surcharge* practice because it was the railroad's position the rate adjustment mechanism under recovered the cost of fuel, especially if fuel prices were volatile.

We undertook a review of publicly available information in an effort to determine if the railroads are over recovering the cost of fuel using existing *Surcharge* practices. Specifically we assembled a comparison table Exhibit JDL-1 for UP and BNSF which shows the cumulative percent change for each carrier's coal fuel surcharge percentage which is applied to a coal customer's freight rate and the percent change in diesel fuel prices actually paid by UP and BNSF.

Column (2) of the Exhibit shows the US average Retail On-Highway Diesel Fuel as reported on the U.S. Department of Energy's web pages. UP assesses a fuel surcharge – Column (3) on coal of 0.5% for every \$0.05 per gallon when Column (2) exceeds \$1.35 per gallon. When Column (2) exceeds \$1.60 UP's coal surcharge increases 0.75% for every \$0.05 per gallon. BNSF assesses a fuel surcharge – Column (7) on coal of 0.5% for every \$0.04 per gallon when Column (2) exceeds \$1.24 per gallon.

Columns (5) and (9) identify the actual price paid for diesel fuel by UP and BNSF between January 2003 and December 2005. The UP and BNSF periodically use derivatives to limit the volatility in the cost of diesel fuel needed for the transportation business. Historically, fuel as a percentage of total railroad expenses has equaled 10%-12%. The current RCAF-U and RCAF-A calculations show that fuel expense represents

12.1% of the Class I total railroad expenses. Our analysis shows that if a rail customer's rate is adjusted by either RCAF index and they are subject to a fuel surcharge, an over recovery would occur because fuel is a component in the RCAF indices market basket. Over recovery will also occur because the fuel surcharges are applied to the entire rail freight rates. This over recovery results because fuel is a portion of a rail rate including other rail costs and profit. A fuel surcharge must be applied to the fuel related portion of a rail rate to eliminate any possible over recovery.

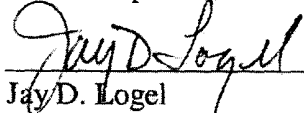
The UP and BNSF use of HDF, a diesel fuel price unrelated to the price of diesel fuel paid by UP and BNSF which has significantly over recovered the railroads cost of fuel. Exhibit JDL-1, Columns (4) and (8) show UP and BNSF coal fuel surcharges increased 940% and 571% respectively between January 2003 and December 2005. During this same time period the railroad's actual fuel prices paid, Columns (6) and (10) increased 108% and 80% respectively. UP's coal fuel surcharge increased 8.7 times the increase UP incurred in actual fuel cost. BNSF's coal fuel surcharge increased 7.1 times the increase BNSF incurred in actual fuel cost. The over recovery from the application of fuel surcharges could be tempered if the railroads rebenchmarked their fuel surcharge when they enter new agreements or amend their circulars and pricing authorities. The railroads failure to rebenchmark the fuel surcharge practice will continue the significant over recoveries we identified in Exhibit JDL-1.

Muscatine supports the railroads need to recover changes in their cost of fuel through the application of fuel surcharges. Changes are needed to the existing fuel surcharge practice to eliminate the significant over recovery that has and continues to occur. We propose the following changes to provide for the railroads recovery of actual fuel costs without an over recovery.

1. Railroads should rebench the fuel surcharge when amending Circulars, Pricing Authority's or entering new rail agreements with rail customers to the level of fuel costs at the time of making the rate determination.
2. Railroads should base the fuel surcharge on the changes on fuel prices actually paid by railroads.
3. The fuel surcharge percentage calculated using proposed changes 1 and 2 should be applied only to the proportion of the rail rate associated with fuel – for example 12.1%.
4. The adjustment mechanism used to adjust the rail rate should exclude fuel to eliminate any over recovery through the application of a fuel surcharge using proposed changes 1 – 3.

I, Jay D. Logel, General Manager, Muscatine Power and Water, Muscatine, Iowa, declare under penalty of perjury that the foregoing is true and correct and represents the opinion of Muscatine Power and Water. Further, I certify that I am qualified and authorized to file this pleading.

Executed on April 26, 2006

By: 
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Comparison of Changes in Fuel Surcharges With Actual Fuel Prices Paid By UP And BNSF

Period (1)	Highway Price 1/ (2)	UP Surcharge 2/ (3)	UP Cumulative % Change 3/ (4)	UP Diesel 4/ (5)	UP Cumulative % Change 3/ (6)	BNSF Surcharge 5/ (7)	BNSF Cumulative % Change 3/ (8)	BNSF Diesel 6/ (9)	BNSF Cumulative % Change 3/ (10)
December-05	\$2.443	26.00%	940.00%	\$2.08	108.00%	23.50%	571.43%	\$1.691	80.28%
November-05	\$2.573	22.25%	790.00%	\$2.08	108.00%	20.00%	471.43%	\$1.691	80.28%
October-05	\$3.095	17.75%	610.00%	\$2.08	108.00%	16.00%	357.14%	\$1.691	80.28%
September-05	\$2.819	15.50%	520.00%	\$1.88	88.00%	14.50%	314.29%	\$1.430	52.45%
August-05	\$2.500	14.00%	460.00%	\$1.88	88.00%	13.50%	285.71%	\$1.430	52.45%
July-05	\$2.373	12.50%	400.00%	\$1.88	88.00%	12.00%	242.86%	\$1.430	52.45%
June-05	\$2.290	14.00%	460.00%	\$1.67	67.00%	13.50%	285.71%	\$1.325	41.26%
May-05	\$2.199	13.25%	430.00%	\$1.67	67.00%	12.50%	257.14%	\$1.325	41.26%
April-05	\$2.292	10.25%	310.00%	\$1.67	67.00%	10.00%	185.71%	\$1.325	41.26%
March-05	\$2.214	9.50%	280.00%	\$1.45	45.00%	9.00%	157.14%	\$1.133	20.79%
February-05	\$2.027	10.25%	310.00%	\$1.45	45.00%	10.00%	185.71%	\$1.133	20.79%
January-05	\$1.961	11.75%	370.00%	\$1.45	45.00%	11.50%	228.57%	\$1.113	18.66%
December-04	\$2.009	8.75%	250.00%	\$1.46	46.00%	8.50%	228.57%	\$1.141	21.64%
November-04	\$2.147	6.00%	140.00%	\$1.46	46.00%	7.50%	142.86%	\$1.141	21.64%
October-04	\$2.134	6.00%	140.00%	\$1.46	46.00%	6.50%	114.29%	\$1.141	21.64%
September-04	\$1.917	5.00%	100.00%	\$1.25	25.00%	6.00%	85.71%	\$0.988	5.33%
August-04	\$1.833	5.00%	100.00%	\$1.25	25.00%	6.00%	85.71%	\$0.988	5.33%
July-04	\$1.793	5.00%	100.00%	\$1.16	16.00%	6.00%	71.43%	\$0.988	5.33%
June-04	\$1.711	4.00%	80.00%	\$1.16	16.00%	6.50%	85.71%	\$0.967	3.09%
May-04	\$1.746	3.50%	60.00%	\$1.16	16.00%	6.00%	71.43%	\$0.967	3.09%
April-04	\$1.692	3.50%	40.00%	\$1.16	16.00%	5.00%	42.86%	\$0.851	-9.28%
March-04	\$1.629	2.50%	40.00%	\$1.02	2.00%	4.00%	28.57%	\$0.851	-9.28%
February-04	\$1.582	2.50%	0.00%	\$1.02	2.00%	3.50%	0.00%	\$0.854	-8.96%
January-04	\$1.561	2.50%	0.00%	\$0.89	-11.00%	3.00%	-14.29%	\$0.864	-7.89%
December-03	\$1.490	2.50%	0.00%	\$0.89	-11.00%	3.00%	-14.29%	\$0.864	-7.89%
November-03	\$1.482	2.50%	0.00%	\$0.89	-11.00%	3.00%	-14.29%	\$0.864	-7.89%
October-03	\$1.495	2.00%	0.00%	\$0.89	-11.00%	3.00%	-14.29%	\$0.864	-7.89%
September-03	\$1.467	2.00%	-20.00%	\$0.90	-10.00%	2.50%	-28.57%	\$0.864	-7.89%
August-03	\$1.487	2.00%	-20.00%	\$0.90	-10.00%	2.50%	-28.57%	\$0.864	-7.89%
July-03	\$1.435	2.00%	0.00%	\$0.88	-12.00%	3.00%	-14.29%	\$0.886	-5.54%
June-03	\$1.424	2.00%	-20.00%	\$0.88	-12.00%	3.00%	-14.29%	\$0.886	-5.54%
May-03	\$1.451	2.50%	0.00%	\$0.88	-12.00%	4.00%	-14.29%	\$0.938	0.00%
April-03	\$1.533	3.00%	20.00%	\$1.00	0.00%	5.00%	57.14%	\$0.938	0.00%
March-03	\$1.708	5.00%	130.00%	\$1.00	0.00%	3.50%	xxx	\$0.938	xxx
February-03	\$1.654	2.50%	xxx	\$1.00	xxx	3.50%	xxx	\$0.938	xxx
January-03	\$1.488	xxx	xxx	\$1.00	xxx	3.50%	xxx	\$0.938	xxx

1/ U.S. Department of Energy - US monthly average Retail On-Highway Diesel Fuel.

2/ Fuel Surcharge as a percentage of freight rate found at UPRR.com.

3/ Cumulative percent change from January 2003 to later period.

4/ 2004 and 2005 Analyst Fact Books found at UPRR.com.

5/ Fuel Surcharge as a percentage of freight rate found at BNSF.com.

6/ Year End 2004 and 2005 Investor Reports found at BNSF.com.