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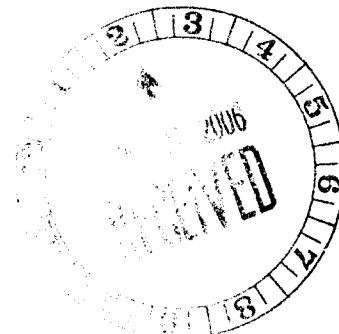
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April 27, 2005

VIA HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Room 711
Washington, D.C. 20423



Re: Ex Parte No. 661, Rail Fuel Surcharges

Dear Secretary Williams:

Enclosed are the original and ten copies of the Written Submission of Kennecott Utah Copper Corporation in the above-referenced proceeding..

Kindly acknowledge receipt of this filing by date-stamping and returning the enclosed extra copy of this letter to our messenger.

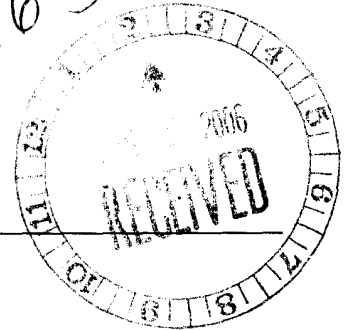
Sincerely,

Christopher A. Mills

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Enclosures

216 383

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



RAIL FUEL SURCHARGES

)
) Ex Parte No. 661
)

**WRITTEN SUBMISSION OF
KENNECOTT UTAH COPPER CORPORATION**

KENNECOTT UTAH COPPER
CORPORATION

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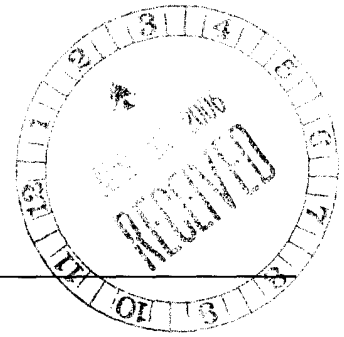
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Dated: April 27, 2005

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**



RAIL FUEL SURCHARGES

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Ex Parte No. 661

**WRITTEN SUBMISSION OF
KENNECOTT UTAH COPPER CORPORATION**

Kennecott Utah Copper Corporation ("Kennecott") submits the following comments in response to the Board's Notice of Public Hearing served March 14, 2006 in this proceeding ("Notice").

As described in the Notice, the basic purpose of this proceeding is to receive views on the manner in which fuel surcharges are calculated and charged by railroads. For the reasons set forth below, Kennecott believes that the present fuel surcharge procedures used by the Class I railroads constitute unreasonable practices because the fuel surcharges are applied as a percentage of the freight rate. This methodology has no real relation to changes in the railroads' actual fuel costs, it does not relate to the railroads' unanticipated fuel cost increases, and it allows the railroads to create separate profit generators outside of freight rates at the expense of the shipper. Kennecott does not here object to fuel surcharges as such, but Kennecott submits that the Board should order the railroads to establish a uniform fuel surcharge mechanism that fairly reflects unanticipated increases in fuel costs for particular movements.

I. Background and Interest of Kennecott

Kennecott is primarily a mining, smelting and refining company with facilities in the Great Basin region of the western United States. Kennecott is the second largest producer of copper in the United States. It produces approximately 300,000 tons of copper cathode per year and supplies about 15% of the nation's copper demand. Kennecott-produced copper comes from the Bingham Canyon Mine located near Salt Lake City, Utah. Kennecott ships copper, primarily by rail, to copper fabricators throughout the United States. Kennecott also produces sulfuric acid as a by-product of the smelting process, amounting to approximately one million tons per year. This acid is sold to fertilizer and industrial customers throughout the United States, and most of it is also shipped by rail.

Kennecott's copper and sulfuric acid production facilities in Utah are directly served by the Union Pacific Railroad ("UP"). BNSF Railway Company ("BNSF") also has access to those facilities using the "Central Corridor" trackage rights it obtained from UP as a result of the Union Pacific/Southern Pacific merger in 1996. Kennecott ships copper and sulfuric acid by rail both to local destinations served by BNSF or UP, and to destinations served by the major midwestern and eastern railroads, Kansas City Southern ("KCS"), Canadian National ("CN"), CSX Transportation ("CSXT") and Norfolk Southern ("NS"). Kennecott pays fuel surcharges to all of these Class I railroads, and thus it has an interest in how they are calculated.

Kennecott is a member of the National Industrial Transportation League (“NITL”), which is submitting both written and oral testimony in this proceeding on behalf of its members. Kennecott endorses that testimony, and in addition Kennecott submits these separate comments to underscore its concerns with how fuel surcharges are being applied to its own rail shipments.

II. The Present Calculation and Application of Railroad Fuel Surcharges Is Unreasonable

Kennecott ships copper and sulfuric acid by the carload, and is subject to the railroads’ fuel surcharges applicable to carload shipments. Kennecott has two basic problems with the way railroad fuel surcharges are calculated and applied to carload shipments.

First, beginning in early 2006, Kennecott has been subjected to substantial increases in freight rates, with the increases in the line-haul rates alone ranging from 15 percent to 59 percent on shipments via UP and BNSF to the highest-volume destinations. Presumably part of the justification for these rate increases was the increases in diesel fuel costs experienced by the railroads, particularly in 2004-05. Notwithstanding that the increased cost of diesel fuel as of the date when the rate increases were implemented was (or should have been) reflected in the higher freight rates, the railroads also imposed substantial and additional fuel surcharges.¹ It is widely recognized, and even

¹ For example, both UP’s and BNSF’s current fuel surcharge (as of April 1, 2006) is 12.5 percent of the freight rate for carload shipments.

acknowledged by the railroads, that fuel surcharges are intended to enable a railroad to recover unanticipated increases in the price of fuel that were not taken into account when the railroad priced its traffic. Kennecott submits that it is unreasonable to apply a fuel surcharge to a new, increased rate unless the railroad demonstrates that its fuel costs as of the date of the increase are substantially higher than when the rate was established.

The second problem with the railroads' present fuel surcharge programs is that the fuel surcharges are applied as a percentage of the total freight rate, rather than being applied so as to cover actual increases in fuel costs.² Fuel comprises only part of a railroad's operating costs. Applying the fuel surcharge as a percentage of the entire freight rate for a given movement means that the surcharge is assessed against not just fuel costs, but against all operating expenses as well as overheads and the profit margin built into the freight rate. This means that the higher the freight rate for a particular movement, the higher the fuel surcharge.

² Each Class I railroad presently uses an index to trigger the application of its fuel surcharge and thereafter to adjust the surcharge periodically. The midwestern and eastern railroads use West Texas Intermediate ("WTI") crude oil prices for their index; the western railroads use the Department of Energy's Energy Information Administration ("EIA") average retail on-highway fuel prices for their index. Neither index relates directly to changes in the railroads' actual cost of diesel fuel. Railroads do not purchase crude oil, nor do they purchase diesel fuel at the on-highway retail level. As NITL points out in its testimony, use of the WTI index results in a greater overstatement of increases in actual railroad fuel costs than the EIA on-highway diesel price index because crude oil prices tend to increase at a faster rate than diesel fuel prices. Kennecott concurs with NITL that a more appropriate index would be the price of U.S. diesel fuel sold in wholesale markets to commercial and institutional consumers, as reported by the EIA, because these prices more fairly reflect the actual wholesale market prices of the fuel that the railroads actually purchase than retail on-highway diesel prices or WTI prices.

An example from Kennecott's own recent experience demonstrates the unreasonableness of the railroads' practice of applying fuel surcharges to new rates and basing the fuel surcharge on a percentage of the freight rate. Kennecott's largest single movement of sulfuric acid is a movement in tank cars from an origin in Utah to a destination in Idaho in single-line UP service. In mid-February 2006, following expiration of a contract covering this movement, UP imposed an increase of about 30 percent in the freight rate for a new, replacement contract. Kennecott believes this 30 percent increase should have been more than sufficient to cover any increases in fuel costs that were not picked up in the prior contract's rate-escalation mechanism. However, UP insisted on applying the carload fuel surcharge (which then equaled 12.0 percent of the freight rate) on top of the rate increase.

There was no change in the way this traffic moved when the rate increase was implemented. The traffic continued to move in tank cars provided mileage-free by Kennecott. There was no change in the tare or lading weight per car, no change in the number of loaded cars tendered at a time for pickup by UP, and no change in the routing used by UP. However, UP's percentage fuel surcharge was the same immediately before and immediately after the rate increase: 12.0 percent. The 30 percent rate increase caused the fuel surcharge amount per car to increase by a similar percentage compared with the surcharge amount that would have applied had there been no rate increase – even though UP's actual fuel costs did not change at all. The sole factor that caused the fuel surcharge amount to go up by 30 percent was the 30 percent increase in the freight rate.

The foregoing real-world example demonstrates the fundamental unfairness of applying a fuel surcharge as a percentage of the freight rate. The burden is heaviest on traffic that pays the highest rates, and the dollar amount of the surcharge is dependent entirely on the level of the freight rate in situations where a freight rate increase is implemented without any change in the underlying operating characteristics of the movement.

This example also underscores the likelihood that the imposition of a fuel surcharge as a percentage of the freight rate is designed to be a generator of secondary profits, rather than as reimbursement for actual unanticipated fuel costs. While such a surcharge is simplistic and uniform in application, it goes well beyond the fundamental purpose of fuel surcharges. It is, in reality, arbitrary and unfair.

III. Alternatives to Present Railroad Surcharge Methodologies

Kennecott understands that the BNSF – alone among the Class I railroads – is in the process of converting from a percentage-based fuel surcharge methodology to a mileage-based fuel surcharge methodology, and has actually converted to a mileage-based surcharge for some commodities such as coal. BNSF's new mileage-based surcharge represents an improvement over a surcharge based on a percentage of the freight rate by reducing the inequities between movements with similar operating characteristics.

However, it still suffers from significant flaws.

First, basing a surcharge entirely on mileage fails to take into account variations in operating characteristics for different movements such as lading weight per

car, cars per train, etc. (although such variations may be partially accounted for by applying different surcharge amounts per mile for commodities with different movement characteristics). Second, the surcharge amount per mile is still based on the EIA average retail price for on-highway diesel fuel, which does not reflect the wholesale prices BNSF actually pays for diesel fuel. Third, moving to a mileage-based surcharge methodology does not guarantee that the methodology will only recover fuel costs, since the mileage rate can be set at a level that allows cost over-recovery. In short, while BNSF's new mileage-based methodology is better than a percentage-based methodology, it still probably over-recovers BNSF's actual fuel costs.

Kennecott notes that the fuel surcharges applied by the midwestern and eastern railroads are based on the price of WTI crude oil, rather than the EIA retail on-highway diesel fuel price used by the western railroads. In most instances this inflates the midwestern/eastern railroads' fuel surcharge percentages above those for the western railroads. For example, in the first four months of 2006 BNSF's and UP's carload fuel surcharges ranged from a low of 12.0 % to a high of 13.5%. In the same period KCS's, CSXT's and NS's fuel surcharges ranged from a low of 14.4% to a high of 17.2%.³ Thus the lowest of these railroads' WTI-based fuel surcharges during this period exceeded the highest of BNSF's and UP's EIA-based fuel surcharges. Currently (in April 2006),

³ CN's fuel surcharge is also based on WTI crude oil prices, but its fuel surcharge percentage was somewhat lower than that of KCS, CSXT and NS.

BNSF's and UP's carload fuel surcharge is 12.5%, whereas KCS's, CSXT's and NS's fuel surcharge is 15.6% – or about 25% higher than BNSF's and UP's surcharges.

It is highly unlikely that KCS, CSXT or NS actually pays 25% more for diesel fuel than BNSF and UP do. Yet this irrational imbalance in burden on the shipper is the result of basing their fuel surcharges on WTI fuel oil prices rather than EIA retail on-highway diesel fuel prices.

As noted earlier, neither index presently used by the Class I railroads has anything to do with what they actually pay for diesel fuel. A better methodology for calculating fuel surcharges is the cost-based methodology advocated by NITL in its testimony in this proceeding, which uses as an index the price of U.S. diesel fuel sold in wholesale markets to commercial and institutional consumers, as reported by the EIA.

Kennecott believes NITL's cost-based methodology is fairer than the methodologies presently used by any of the Class I railroads because it would confine fuel surcharges to their proper role: the recovery of unusual fuel costs, caused by unanticipated increases in the price of diesel fuel that were not taken into account when the railroad priced its traffic. It would prevent the railroads from using fuel surcharges to over-recover their actual fuel costs, thus improperly making such surcharges a generator of secondary profits over and above the line-haul rates themselves. Kennecott urges the Board to give serious consideration to the cost-based fuel surcharge methodology proposed by NITL.

Respectfully submitted,

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Dated: April 27, 2006

Its Attorneys