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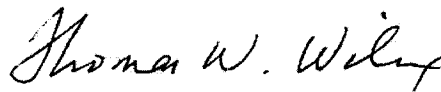
The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001

Re: **Joint Comments of Nevada Power Company, Sierra Pacific Power Company and Idaho Power Company, in response to Rail Fuel Surcharges, Ex Parte 661 (STB served Mar. 14, 2006)**

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are the Joint Comments of Nevada Power Company, Sierra Pacific Power Company, and Idaho Power Company.

Sincerely,



Thomas W. Wilcox
An attorney for Nevada Power Company, Sierra Pacific Power Company and Idaho Power Company

Enclosure

cc: Colleen J. Rice, Esq.
Mr. Tom J. Harvey
Mr. Joseph R. Brignola

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 661

REVIEW OF RAIL FUEL SURCHARGES

**JOINT COMMENTS OF NEVADA POWER COMPANY,
SIERRA PACIFIC POWER COMPANY AND
IDAHO POWER COMPANY**

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April 27, 2006

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 661

RAIL FUEL SURCHARGES

**JOINT COMMENTS OF NEVADA POWER COMPANY,
SIERRA PACIFIC POWER COMPANY
AND IDAHO POWER COMPANY**

I. INTRODUCTION

On March 14, 2006, the Surface Transportation Board ("Board" and "STB") issued a notice of public hearing on rail fuel surcharges to be held on May 11, 2006, and invited interested parties to submit comments on railroad fuel surcharges (hereinafter "Notice"). Nevada Power Company ("Nevada"), Sierra Pacific Power Company ("Sierra"), and Idaho Power Company ("Idaho") hereby submit these joint comments in response to the Board's invitation.

As explained in these comments, Nevada, Sierra and Idaho are all rail shippers utilizing the Union Pacific Railroad ("UP") for rail transportation. At present the facilities referenced below burn coal delivered by UP from coal mines in Utah and Wyoming. Accordingly, these comments are focused on the fuel surcharge established by UP and set forth in Item 690 of UP Circulars 6602-C and 6603-C, Applying on Loading, Handling, Accessorial Charges, Fuel Surcharges and General Rules for Trains Originating in (1) Colorado and Utah, and (2) Wyoming, respectively. Nevada, Sierra and Idaho believes that the fuel surcharge mechanism

imposed by UP in Item 690 may overcompensate UP for the actual fuel it expends for their respective movements.

A. Nevada Power Company Identity and Interest

Nevada is a wholly-owned operating subsidiary of Sierra Pacific Resources. It has a service area of over 4,000 square miles in southern Nevada, including Las Vegas. Along with several other facilities, Nevada operates the 590-MW coal-fired Reid Gardner generating station in Moapa, Nevada, about 50 miles northeast of Las Vegas. Reid Gardner began operations in 1965. Virtually all of the coal burned at Reid Gardner comes from mines in Utah and Colorado. This coal is delivered to Reid Gardner by UP, the only railroad with access to the plant. Rail is the only feasible means of transporting the coal to Reid Gardner due to the large volume of coal required to operate Reid Gardner, approximately two million tons annually, as well as the distance between the plant and its coal supply.

B. Sierra Pacific Power Company Identity and Interest

Sierra is a wholly-owned operating subsidiary of Sierra Pacific Resources and has a service area of over 50,000 square miles mostly in western and central Nevada, including the city of Reno and the Lake Tahoe area of California. Sierra has provided electricity for more than 140 years and now serves over 1 million customers. Sierra and the Idaho Power Company jointly own the 530 MW coal-fired North Valmy Electric Generating Station in Valmy, Nevada. North Valmy is operated by Sierra and produces electricity for thousands of residents and businesses in Nevada and northeastern California. The plant also serves as a generating resource for Idaho Power's customers in southern Idaho, eastern Oregon, and northwestern Nevada. North Valmy can burn up to two million tons of high-BTU, low-sulfur coal per year. At present, all of the coal

burned at North Valmy is transported to the plant by UP; approximately half of it comes from Utah and half from Wyoming.

C. Idaho Power Company Identity and Interest

Idaho is involved in the generation, purchase, transmission, distribution, and sale of electric energy in a 24,000 square mile area in southern Idaho and eastern Oregon. Its service area includes almost 900,000 people. In addition to its joint ownership of the North Valmy Electric Generating Station, Idaho also owns a one-third interest in the Jim Bridger Generating Station near Rock Springs, Wyoming. As stated above, the North Valmy Station relies on UP rail service and presently burns both Utah and Wyoming coal. The Jim Bridger Station, which is also owned by PacifiCorp, annually burns approximately three million tons of Wyoming coal, which is also delivered by UP.

D. Summary of Comments

Within the past two years, Nevada, Sierra and Idaho each began paying millions of dollars in fuel surcharges to UP annually while at the same time enduring substantial increases in the level of base rates for transportation to the aforementioned facilities as rail transportation contracts for those facilities expired. As explained in Section III of these comments, Nevada, Sierra and Idaho believe the revenues received by UP pursuant to its fuel surcharge formula in Item 690 have overcompensated UP for its actual fuel costs associated with its transportation of coal to their facilities. Nevada, Sierra, and Idaho believe they can demonstrate this for each of their coal movements. However, since those coal movements are presently governed by confidential contracts, this analysis cannot be presented to the STB in this public forum. This also might limit ability of these parties in the short term to benefit from any action the STB might take to reduce or eliminate the surcharge set forth in Item 690. However, Nevada, Sierra,

and Idaho believe that the Board's review of the current rail fuel surcharge practices is extremely important to all shippers and clarification on the issues that presently surround fuel surcharges will be critical as transportation contracts expire and new terms are negotiated.

The reasonableness of the current fuel surcharges established by the railroads generally and UP specifically in their pricing circulars and other public documentation can be reviewed by the Board pursuant to its jurisdiction over unreasonable practices under 49 U.S.C. § 10702. To the extent the Board permits UP to continue to assess a fuel surcharge, the Board should establish narrow, cost-based standards that allow UP to only recover from its individual customers significant, short term increases in the fuel costs for their movements. The Board should also recognize that the recent use by individual railroads of the All-Inclusive Index Less Fuel ("AIILF") developed by the Association of American Railroads ("AAR") in conjunction with a fuel surcharge in lieu of the Rail Cost Adjustment Factor ("RCAF") is not an alternative or industry practice arrived at via mutual agreement by shippers and railroads. Rather the advent of the AIILF in recent years is more a reflection of the significant market power and negotiating leverage currently possessed by the Class I railroads. As such, the correction of railroad practices regarding fuel surcharges must be accompanied by improvements in the Board's rate setting processes and in the facilitation of railroad competition.

In this proceeding, the Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate; (2) clarify that fuel surcharges may only be imposed for the sole purpose of recovering actual costs of fuel expended for a particular shipper's transportation that are not recouped by other means; (3) take appropriate action to correct Item 690 to the extent it does not comport with the above standard; and (4) require UP to submit detailed data reflecting its actual cost of fuel and the revenues

associated with fuel cost recovery associated with each Nevada, Sierra and Idaho movement for which the fuel surcharge is assessed.

II. THE STB HAS AUTHORITY TO REVIEW RAILROAD FUEL SURCHARGES

A. Interstate Commerce Commission Treatment of Fuel Surcharges

1. The *Ex Parte No. 311* Proceeding

This proceeding is not the first time fuel surcharges have come to the attention of federal regulators, or the first time railroad fuel surcharges have been questioned for over recovering fuel costs. Prior to passage of the Staggers Rail Act of 1980¹ and the adoption of the RCAF discussed below, railroads had to seek prior approval of any rate increases, and approved increases could not go into effect for 30-45 days.² When fuel prices increased significantly as a result of the Arab oil embargo in 1973, the Interstate Commerce Commission ("ICC") determined that the existing process for general rate increases, including the 30-45 day waiting period, "may not be adequate in the present circumstances to offset anticipated increases in fuel prices." 40 Fed. Reg. 5374 (1975). It commenced a proceeding in order to allow railroads and motor carriers to increase transportation rates more expeditiously. *Ex Parte No. 311, Effect of Modifying Proclamation No. 3279 and Other Anticipated Energy Conservation Measures on the Operation of Carriers Subject to the Interstate Commerce Act*, 350 ICC 563, 564 (1975) ("Ex Parte No. 311"). After a comment period, the ICC adopted expedited procedures providing interim relief from the regular 30-day notice required, but only if fuel prices were to escalate in the future as expected. *Id.* at 567.

¹ Staggers Rail Act of 1980, 96 P.L. 448 (October 14, 1980).

² See former 49 USC § 10762, as described in, e.g., *The Hanna Mining Company v. The Escanaba and Lake Superior Railroad Co.*, 498 F.Supp. 1267, 1269 (E.D. Mich. 1980).

In allowing this interim relief, the ICC declined to use fuel surcharges. Specifically, the ICC had permitted the imposition of fuel surcharges on an "experimental basis" in 1973-74, primarily for motor carriers. *Id.* at 566. In *Ex Parte No. 311* the ICC clarified that

It has been the traditional view of this Commission that surcharges which add an element of confusion into tariff use should only be sanctioned in unusual situations. Generally, surcharges have only been considered as appropriate in situations where it is anticipated that their use will be of temporary duration or where in extenuating situations the service performed under the surcharge is considered local to the carrier assessing the charge."

Id. at 572 (emphasis added). Lastly, the ICC noted that while the price of fuel appeared as if it would remain higher for the foreseeable future, "the surcharge method of computing freight charges" was not an appropriate way to increase rates permanently. *Id.*

Because the ICC did not implement the expedited procedures adopted in *Ex Parte 311* until 1979 and railroads did not begin recovering the high fuel costs of 1973-74 until June of 1979, the ICC in 1980 approved a 1.2% railroad fuel surcharge instituted as a general rate increase. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge, April 11, 1980*, 364 ICC 336 (1980). In this decision, the ICC utilized the *Ex Parte 311* procedures ("even though...created for different purposes") because they represented the "best way to consider a fuel related surcharge." *Id.* at 337-338. The ICC initially declined to adjust the application of the surcharge on an individual shipper basis, but in response to a successful appeal by Central Power & Light Company, the ICC removed the 1.2% surcharge as applied to that shipper because it shipped no traffic during the period in question. ICC Docket No. 37423, *Temporary Fuel Shortfall Recovery Surcharge, April 11, 1980*, 365 ICC 299 (1981). The ICC eventually permitted a total of 4.7% of such surcharges to account for the delay in implementing *Ex Parte No. 311*; ICC Docket No. 37316, *Rates on Coal, Decker and Kleenburn to Illinois and Indiana*,

364 ICC 158, 160 (1980) (describing ICC use of *Ex Parte No. 311* to authorize fuel surcharge of 4.7% in the first nine and a half months of 1979). In several instances, railroads tried to apply the 4.7% increase to individual movements that were already subject to existing rate and rate escalation arrangements. In these cases, however, the criteria utilized by the ICC to determine whether application of the surcharge was appropriate included whether the revenue generated by the surcharge was justified by the actual fuel costs incurred by the railroad or railroads to provide the service to that particular shipper or shipper or group of shippers, and whether the railroad was recovering fuel costs by other means. *Id.*, 364 ICC 158 (1980); and ICC Docket 37315F, *Coal, Colstrip, Kuehn, and Decker, MT to Superior, WI*, 364 ICC 152 (1980). In the latter case, the ICC noted in particular that the railroad did not demonstrate that it would be harmed by waiting until it recovered the additional fuel costs for that movement through operation of the rate adjustment provision that had been agreed upon by the parties. *Id.* at 156.

In summary, prior to the passage of the Staggers Rail Act of 1980 and the development of the RCAF, the ICC permitted fuel surcharges in very narrowly prescribed circumstances to permit recovery of extraordinary and temporary increases in fuel costs prior to recovering such costs in rate increases or through a rate adjustment provision. Moreover, attempts to broadly apply surcharges to individual movements required some showing that the revenues generated by the surcharge did not exceed the actual fuel costs, particularly as parties developed rate adjustment indexes and formulas that would enable the eventual recovery of the costs of moving the shipper's traffic, including fuel costs.

2. The Effect of the Adoption of the Rail Cost Adjustment Factor on Fuel Surcharges

In part at the behest of Congress, the ICC proposed in 1980 to replace the procedures for filing general rate increases with a procedure based on an inflation index, the RCAF. *Advance*

Notice of Proposed Rulemaking, 45 Fed. Reg. 29103 (May 1, 1980). In publishing the proposed rules, the ICC stated that "the procedures proposed in this notice will permit railroads to recover fuel cost increases along with other cost increases on a quarterly basis...We thus propose that our current *Ex Parte 311* fuel surcharge mechanism be discontinued." *Ex Parte* No. 290 (Sub No. 2), *Railroad Cost Recovery Procedures*, 45 Fed. Reg. 81217 (Dec. 10, 1980).

The ICC adopted the newly-created RCAF railroad index just a few months later in April of 1981. *Ex Parte* No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, 364 ICC 841 (1981). According to the ICC, adoption of this index "permit[s] railroads to recover fuel cost increases along with other cost increases on a quarterly basis." *Id.* at 852. Furthermore, the RCAF meant that "[m]aintaining a separate surcharge mechanism for fuel would, in our view, serve no useful purpose once these rules are in place, and would, in fact, only complicate the operation of the new system." *Id.*

A few years later, the ICC adopted a revised methodology for the RCAF index based on data gathered and submitted by the Association of American Railroads ("AAR"). *Ex Parte* No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, 1 ICC2d 207 (1984). In stating again that the creation of RCAF was in response to the Staggers Act, the ICC noted that "[w]e believe it was the intent of that Act to simplify the procedures for increasing rail rates and that the application of the single RCAF to all base rates best accomplishes that intent." *Id.* at 208. For the fuel component of the RCAF, the ICC considered a variety of shipper proposals but eventually decided that a survey of actual prices paid by railroads, which was prepared by the AAR, was the best measure of the price of railroad diesel fuel. *Id.* at 217-218.

These statements from the ICC reveal that the RCAF was intended to not only replace the general rate increase method of adjusting rail rates with a simpler method, but also to supplant

the need for fuel surcharges. Shippers and the AAR proposed competing methods of incorporating the price of fuel into the RCAF, but the ICC chose the AAR's method. In other words, in response to the ICC's request for rate adjustment methods that would replace the fuel surcharge mechanism, the railroads developed a method for incorporating fuel price that was approved by the ICC. Any change to this railroad-proposed and ICC-approved mechanism for incorporating fuel price in rates should only come in a regulatory rulemaking.

The RCAF index is based on quarterly filings made by the AAR. These filings include a forecasted railroad fuel cost for the next calendar quarter which is a mix of (1) actual diesel prices paid by railroads (for the weighting component) and (2) various projections by the major railroads' fuel purchasing officers and others regarding the level of railroad diesel prices during the next quarter.³ These quarterly filings reveal that the RCAF methodology takes into account the fluctuation of railroad diesel prices caused by events in the world oil markets. For example, the filing made on December 5, 2005 by the AAR described the damage done by hurricanes Katrina and Rita as largely responsible for the rise in the fuel component of the RCAF. Ex Parte No. 290 (Sub-No. 5) (2006-1), *Quarterly Rail Cost Adjustment Factor*, AAR forecast, Appendix B (page 1) (filed Dec. 5, 2005). These are exactly the same reasons now cited by the railroads in justifying the use of their privately developed fuel surcharges.

In adopting the methodology for calculating the RCAF, the ICC stated that "significant problems in the accuracy of fuel data" could warrant a change in the fuel component of the RCAF index. *Railroad Cost Recovery Procedures*, 1 ICC 2d at 218. In other words, there is a standing invitation to all parties to petition the Board for a change in the RCAF if they feel it does not accurately reflect railroad fuel prices.

³ See generally "Rail Cost Adjustment Factor," a publication from the Association of American Railroads (November 2001).

3. The Recent Use of the All-Inclusive Index Less Fuel is a Circumvention of the RCAF and a Means to Justify the Use of Separate Fuel Surcharges That Over Recover Fuel Costs.

In recent years, some of the Class I railroads have shifted away from using the RCAF and have begun utilizing the AAR's AIILF in rail transportation contracts. Unlike the RCAF, the AIILF has not been formally approved by the Board, meaning the railroads, through the AAR can change the index without seeking the Board's permission. Under this scenario, justification for applying the fuel surcharge is based on the rationale that the AIILF does not contain a full component, so no double count of fuels costs occurs as would be the case if the RCAF applied. However, used in this manner, Item 690 is not a true "surcharge" at all, but rather a separately established mechanism to adjust any increase (but not decreases) in the railroad's fuel costs. However, as shown below, the formula used in Item 690 fuel surcharge virtually assures that UP will receive additional revenue by operation of the formula even if the cost of fuel for a particular movement does not increase over the term of the movement.

B. The Lawfulness of Railroad Fuel Surcharges Should be Reviewed Pursuant to the Board's Authority under 49 U.S.C. § 10702(2) Governing Unreasonable Practices.

1. Clarification from the Board is Needed

While the ICC decisions referenced above discuss the ICC's treatment of fuel surcharges, there is no clear Board precedent on this particular subject. Specifically, there is no precedent stating definitively whether the Board considers a fuel surcharge to be part of the rate for transportation or a "rule" or charge whose reasonableness can be challenged independent of the transportation rate. This lack of clear guidance is evident from filings in recent cases. For example, in STB Docket No. 42072, *Carolina Power & Light v. Norfolk Southern Railway Company*, the parties disagreed over whether NS could assess a fuel surcharge on top of a

maximum reasonable rate prescribed by the Board in a case brought under the *Coal Rate Guidelines Nationwide*. ICC 2d 520 (1985). While CP&L had claimed that all fuel costs had already been incorporated into the stand-alone cost (“SAC”) analysis and prescribed rates over the DCF period, NS claimed the surcharge was a separate “rule” that had not been separately challenged by CP&L and, therefore, was not at issue in the case. CP&L Statement of Position at 8-9 (filed June 4, 2004), NS Statement of Position (filed June 4, 2004) at 2. The Board did not resolve this question in *CP&L*. STB Docket No. 42072, *CP&L v. NS* (served Oct. 20, 2004) at 6. The same general question has been posed to the STB in other SAC cases, but no answers have been provided. See, e.g., STB Docket No. 42088, *Western Fuels Association v. Burlington Northern Santa Fe Railway Company*, (complaint filed October 1, 2004); STB Docket No. 42095, *Kansas City Power & Light Company v. Union Pacific Railroad*, (complaint filed October 12, 2005). Nevada, Sierra, and Idaho believe that the lack of Board guidance on fuel surcharges is one reason shippers have not formally challenged fuel surcharges outside of the SAC context.

2. The Assessment of Fuel Surcharges is a Railroad Practice Subject to the Board’s Jurisdiction.

Under 49 U.S.C. §§ 10702 and 10704(a)(1), the Board has authority over railroad practices. If a railroad practice is found to be unreasonable, the Board can order the railroad to cease engaging in it or the Board can prescribe the “practice to be followed.” 49 U.S.C. § 10704(a)(1). Whether or not a particular railroad practice is unreasonable requires the Board to engage in a “fact-specific inquiry” to be conducted on a “case-by-case” basis. STB Docket No. 42092 *WTL Rail Corporation – Petition for Declaratory Order and Interim Relief* (served February 17, 2006) at 6.

UP's fuel surcharge is contained in UP's publicly available public pricing documents, such as the 6600, 6602, 6603, and 6605 Circulars. While Nevada, Sierra, and Idaho's coal transportation is currently via coal transportation contracts with UP, this should not be relevant for the purposes of this proceeding. The incorporation of standard railroad fuel surcharges into rail transportation contracts by reference over the shipper's objections is a significant issue when new rail transportation contracts are negotiated, particularly for facilities captive to a single railroad. In today's commercial and railroad regulatory environment, captive coal shippers are forced to either (1) incorporate the published fuel surcharge into a new contracts containing a substantial rate increase; or (2) pay even higher common carrier rates *in addition to* the surcharge and endure the extraordinary cost, length of time, and substantial uncertainty of a rate reasonableness case at the Board. As such, the Board's determination of whether a particular railroad's public fuel surcharge formula is a reasonable practice should include an analysis of the costs and revenues associated with traffic moving under transportation contracts that incorporate the surcharge by reference, consistent with any confidentiality obligations set forth in the contracts.

Fuel surcharges are universal rules or charges subject to Board jurisdiction as "transportation-related" practices such as demurrage. STB Docket No. 42068 *Capitol Materials Incorporated – Petition for Declaratory Order – Certain Rates and Practices of Norfolk Southern Railway Company*, (served April 12, 2004) at 2. The manner in which the railroads calculate and assess their individual fuel surcharges is subject to a determination of reasonableness under 49 U.S.C. § 10702. In order to ensure that railroad practices are reasonable, the Board has previously used its authority under 49 U.S.C. § 10702 to assert jurisdiction over various other railroad rules and surcharges. The Board has evaluated the

specific demurrage charges assessed against a shipper under the unreasonable practice standard. *Capitol Materials* at 6. The Board has found a light-density line surcharge to be an unreasonable practice when used in conjunction with contract service. STB Docket No. 42031 *Parrish & Heimbecker, Inc. – Petition for Declaratory Order* (served May 26, 2000) at 10. The Board has begun a proceeding to evaluate BNSF's imposition of storage and demurrage charges on all types of empty private cars awaiting loading is an unreasonable practice. STB Docket No. 42060 (Sub-No. 1), *North America Freight Car Association – Protest and Petition for Investigation – Tariff Publications of the Burlington Northern and Santa Fe Railway Company*, (served August 13, 2004) at 9. The Board has also evaluated whether it was unreasonable for a railroad to limit the hours its track could be used by a second railroad under a trackage rights agreement. STB Docket No. 42083 *Granite State Concrete Co., Inc. and Milford-Bennington Railroad Company, Inc. v. Boston and Maine Corporation and Springfield Terminal Railway Company*, (served September 24, 2004) at 1.

3. Shippers should be able to challenge specific fuel surcharges without using the Board's rate reasonableness procedures.

As Section II.B.1 shows, the Board can evaluate the Class I railroads' general fuel surcharges under the unreasonable practice standard of 49 U.S.C. § 10702. There is no need to evaluate a specific fuel surcharge level only in conjunction with assessing the reasonableness of the rate for transportation. As an initial matter, such a requirement would insulate surcharges assessed on movements to dual served locations from any regulatory scrutiny, since current law would dictate that the Board has no jurisdiction due to a lack of market dominance. 49 U.S.C. § 10707.

Moreover, requiring a captive coal shipper to file a rate case under the *Coal Rate Guidelines* to challenge merely whether a railroad's fuel surcharge practice is reasonable would

also virtually insulate such surcharges from Board scrutiny. As stated above, Railroads are currently able to use their market power to force their customers to incorporate the published fuel surcharges by reference into a new transportation contract without modification. Once the contract is signed, the shipper's ability to object to the fuel surcharge becomes severely limited due to the Board's lack of jurisdiction over rail transportation contracts. In short, a shipper must either pursue difficult contract claims, such as a claim that the inclusion of the surcharge is an unlawful "contract of adhesion" or agreed to under duress, or hope either (1) that the railroad unilaterally reduces the fuel surcharge and that the successor surcharge applies to the contract service, or (2) that an action by the STB requires the railroad to reduce or eliminate the surcharge and that this action also applies to the contract service.

In any event, a fuel surcharge is a universally-applicable tariff item that exists independently of the rate. As the Board recognized in the Notice, whether a fuel surcharge is a reasonable practice can be determined by examining whether mechanism developed by the individual railroad for the stated purpose of recovering fuel cost increases that is not recovered by other means "fairly reflect[s] the increasing fuel costs of the particular movements to which [it is] applied." Notice at 2. There is no need for a stand-alone cost or other rate analysis to make this determination. For example, the Board has previously determined the reasonableness of a particular demurrage charge without resort to rate reasonableness standards. *Capitol Materials* at 4 (finding a \$60 per day demurrage charge to be reasonable without resort to the rate reasonableness standards). The determination of whether a purported fuel surcharge fulfills its cost recovery purpose can be aided by the submission of fuel cost and revenue data by the railroad(s) seeking to assess the fuel surcharge.

**III. THE FUEL SURCHARGE PRACTICE ESTABLISHED IN ITEM 690
OVERCOMPENSATES UP FOR THE FUEL COSTS OF INDIVIDUAL MOVEMENTS**

A. Summary of UP Item 690

Item 690 in UP Circulars 6602-C (coal from Utah) and 6603-C (coal from Wyoming) is applied to line haul freight charges when the average price of Retail Highway Diesel Fuel ("HDF") calculated monthly, equals or exceeds \$1.35 per gallon. When this threshold is met, a fuel surcharge of 1.5% times the line haul rate is triggered. For every five cent increase above \$1.35 per gallon, the multiplier increases 0.5%. The fuel surcharge is applied to the freight charge for each shipment having a bill of lading dated on or after the 1st day of the second calendar month following the month with the HDF price increase. The average price is determined by adding the weekly HDF and dividing the result by the number of weeks reported, rounded to the nearest cent. The freight charge will never be reduced below the base freight charge as a result of applying the fuel surcharge. Also, Item 690 specifies that application or the removal of the fuel surcharge will not be retroactive.

B. UP's Stated Purpose for Item 690

UP's Item 690 is purportedly an attempt to recover incremental costs for diesel fuel allegedly caused by the volatility in the diesel fuel market. The overall goal of the UP fuel surcharge program is "100 percent recovery of higher fuel costs." UP's 2005 Annual Report at 2. UP continues to apply its fuel surcharge program to as much traffic as possible, stating that "we will continue to increase the amount of traffic subject to fuel surcharge programs." *Id.* at 19.

C. Item 690 Over-recovers UP's Fuel Costs for Individual Movements

Item 690 clearly does more than permit UP to recover temporary spikes in the cost of fuel for a particular rail movement. In the first place, use of the HDF monthly average as a basis for the surcharge is not representative of actual fuel costs because the HDF is a retail price index.

Like all the other Class I railroads UP buys diesel fuel in bulk and pays wholesale prices, not retail prices for its fuel. In 2005, UP paid an average of \$1.77 per gallon of diesel, but the average HDF price used in Item 690 during the year was \$2.40 per gallon. *Id.* at 26.⁴ Moreover, due to the fact that Item 690 merely acts as a multiplier of transportation rates, it does not take into account the fuel efficiency gains achieved by UP. Fuel usage by UP locomotives was 2% more efficient in 2005 compared to 2004; efficiency increased another 2% in the first quarter of 2006 compared to the first quarter of 2005. *Id.* at 16; *see, also*, UP Form 8-K, filed with the Securities and Exchange Commission ("SEC") on April 20, 2006. Lastly, UP utilizes an array of other strategies to reduce its exposure to volatility of diesel prices. *See* UP's 2005 Annual Report at 35 ("We may use swaps, collars, futures and/or forward contracts to further mitigate the impact of adverse fuel prices changes."); UP's 2003 Annual Report at 16 ("To help reduce the impact of fuel price volatility on earnings...we will continue to adhere to our hedging strategy.").

Over-recovery of fuel costs is also suggested by UP's recent financial results. In the further quarter of 2005, UP revenues increased \$404 million compared to the 2004 fourth quarter, but the UP "fuel and utilities" category of operating expenses increased only \$220 million. UP Form 8-K, filed with the SEC on January 19, 2006. Similarly, for the first quarter of 2006, UP's operating revenue was \$558 million higher than the first quarter of 2005, but its "fuel and utilities" expenditures increased only \$153 million. UP Form 8-K, filed with the SEC on April 20, 2006.

The built-in differential between UP's actual fuel costs and its over-recovery under Item 690 is compounded because UP has not adjusted its surcharge to account for the fact that increases in the cost of diesel fuel are eventually reflected in newly established transportation

⁴ The HDF table of fuel prices is found at http://www.uprr.com/customers/surcharge/surcharge_coal.shtml.

rates. *See, Ex Parte No. 311*, 350 ICC at 572 (1975) Specifically, as discussed above, the HDF is not a measurement of UP's actual fuel costs. Nevertheless, the last time the HDF was below \$1.35 was in August, 2002.⁵ In April 2006 the HDF was \$2.72.8. *Id.* As UP has negotiated or established new transportation rates to individual shippers such as Nevada, Sierra, and Idaho since the September, 2002 timeframe, such rates have presumably included UP's current cost of locomotive fuel, as well as that particular movement's share all of UP's current variable and fixed costs. To the extent that subsequent to the establishment of such new rates UP's actual fuel costs do not "spike," or fuel cost increases are covered by a rate adjustment provision such as the RCAF, there is no justification for assessing a fuel surcharge to the transportation rate because the new rate would reimburse UP for all of the fuel costs it incurs to provide the issue transportation. Nevertheless, in the preceding circumstances, for a transportation rate that went into effect on January 1, 2006, the operation of Item 660 and the fuel surcharge multiplier would increase the rate by 18.6% the date UP began issuing invoices for shipments under the new arrangement. This necessarily provides substantial additional revenue to UP for the particular movement that cannot be related to additional fuel costs. Moreover, to the extent UP is providing the subject transportation pursuant to common carrier rates established pursuant to Circulars 111, 112, or 113, UP has reserved its right under applicable law "to adjust or cancel rates subject to 20 days' notice for increases." *See, e.g.*, UP Circular 112 at 2. This provides a further means for UP to recover increased fuel costs, subject to the STB's jurisdiction that the increased rate is reasonable. The application of the surcharge and the right to increase common carrier rates on 20 days notice clearly results in over recovering increased fuel costs.

This over recovery is further compounded by the fact that the multiplier is largely independent of the distance of the movement or any other characteristics that affect fuel

⁵ <http://tonto.eia.gov/dnav/pet/hist/ldr001m.htm>.

consumption for a particular movement. While such characteristics are necessarily factored into the transportation rate to some extent, railroad rates are not established solely based on the railroad's costs. Indeed, in today's commercial and regulatory atmosphere, railroads rates are established at levels substantially above a railroad's costs, particularly for captive rail shippers. The present lack of meaningful railroad competition and uncertain regulatory avenues for relief from high rail rates has contributed to the degree to which UP's surcharge in Item 690 has overcompensated UP for any increases in the price of diesel fuel it consumes on Nevada, Sierra, and Idaho's movements.

IV. THE BOARD SHOULD REQUIRE THE SUBMISSION OF REVENUE AND COST DATA JUSTIFYING THE IMPOSITION OF RAILROAD FUEL SURCHARGES

To the extent the Board does not believe it already receives enough data from the Class I railroads, or has not received enough data from the Class I railroads as a result of this proceeding, to enable the Board to determine whether a particular fuel surcharge provides a railroad with more revenue than it needs to recover the railroad's fuel costs for a particular movement, the STB should adopt procedures to govern the submission of such data. The STB has clear authority to obtain the data it needs under 49 U.S.C. § 721(b).⁶ Railroads already provide certain fuel cost data to the AAR on a quarterly basis through the RCAF process. 49 U.S.C. § 10708.⁷ In addition, the Board also requires railroads to submit certain cost and revenue data under 49 CFR

⁶ 49 U.S.C. § 721 (b) (2006). "Inquiries, Reports, and Orders. - The Board may - (1) inquire into and report on the management of the business of carriers providing transportation and services subject to subtitle IV; (2) inquire into and report on the management of the business of a person controlling, controlled by, or under common control with those carriers to the extent that the business of that person is related to the management of the business of that carrier; (3) obtain from those carriers and persons information the Board decides is necessary to carry out subtitle IV; and (4) when necessary to prevent irreparable harm, issue an appropriate order without regard to subchapter II of chapter 5 of title 5."

⁷ 49 U.S.C. § 10708 (a) (2006). "Rail cost adjustment factor: (a) The Board shall, as often as practicable, but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Board, with appropriate adjustments to reflect the change in composition of railroad costs, including the quality and mix of material and labor)...."

Parts 1200 through 1300. Furthermore, railroads are required to report certain information regarding carrier rates and service terms pursuant to 49 CFR Parts 1300 through 1332. Nevada, Sierra, and Idaho assert that the data requirements should include information on revenues from fuel surcharges under contracts, since many contracts now incorporate the public fuel surcharge by reference without any modifications. The Board has the requisite power to use existing or add regulations to obtain any additional information needed to substantiate that "railroad fuel surcharges are being set in such a manner as to insure that they are used only to recover the increased cost of fuel for the particular movements to which the surcharge is applied." Notice at 2.

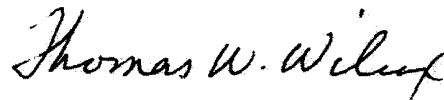
Finally, high fuel surcharges coupled with increasingly poor service has caused public confidence in the rail system to deteriorate. Rail transportation becomes increasingly vital to shippers, particularly coal shippers. Rail service failures and reliability problems have hindered utilities' coal supplies. A mild winter and utility coal conservation measures averted coal inventory problems thus far. However, rail service needs improvement in order to return coal stockpiles to acceptable levels. One part of restoring public confidence in railroad service and reliability is for the railroads to actively participate with the Board and shippers to alleviate the fuel surcharge discrepancy.

VI. Conclusion

Nevada Power, Sierra, and Idaho applaud the Board for taking action on the fuel surcharge issue and holding a public hearing. The Board must now take definitive steps to rectify the problem. The Board should (1) provide clarification that the lawfulness of a railroad fuel surcharge may be challenged separately from the level of a railroad rate under the Board's authority to regulate railroad practices; (2) clarify that railroad fuel surcharges may only be used

for the purpose of recovering actual costs of fuel expended for a particular shipper's transportation that are not recouped by other means (3) take appropriate action to correct the UP's current fuel surcharge in Item 690 to the extent it does not comport with the above standard; and (4) require UP to submit detailed data reflecting its actual cost of fuel and the revenues associated with fuel cost recovery associated with each movement for which the fuel surcharge is assessed.

Respectfully submitted,



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