

John E. Shelk
President and CEO



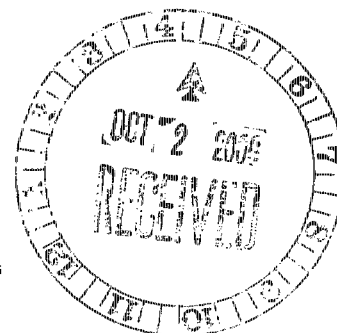
Electric Power Supply Association
Advocating the power of competition

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October 2, 2006

Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001
Attn: STB Ex Parte No. 661

217702



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RE: STB Ex Parte No. 661 - Rail Fuel Surcharges

Dear Surface Transportation Board:

Referencing the May 11th hearing, please find enclosed the comments of the Electric Power Supply Association. Should you have any questions, please feel free to call Andrea Spring at (202) 628-8200.

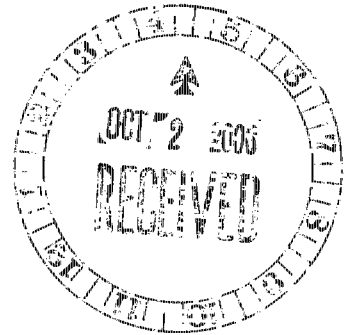
Sincerely,

A handwritten signature in black ink, appearing to read "John E. Shelk". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

John E. Shelk
President and CEO

Enclosure

217702



Before the
SURFACE TRANSPORTATION BOARD
Washington, D.C. 20423

RAIL FUEL SURCHARGES

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STB Ex Parte No. 661

REPLY OF THE
ELECTRIC POWER SUPPLY ASSOCIATION
TO STB DECISION AND REQUEST FOR COMMENTS
DATED AUGUST 3, 2006

Electric Power Supply Association
1401 New York Avenue NW, 11th Floor
Washington, DC 20005
Dated: October 2, 2006

The Electric Power Supply Association supports the Surface Transportation Board's August 3, 2006 Ex Parte No. 661 Decision on Rail Fuel Surcharges as an important step in the right direction in dealing with increasing rail delivery costs. We appreciate the STB addressing many of the equity and transparency concerns shippers raised at the May 11, 2006 hearing regarding rail fuel surcharges. We add a fifth fuel surcharge concern that the STB should also address, and support the four changes proposed in the decision.

The Electric Power Supply Association (EPSA) is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, and fully one-third of actual generation, provide reliable and competitively priced electricity from environmentally responsible facilities. We seek to bring the benefits of competition to all power customers.

EPSA members and the competitive power sector as a whole operate a fleet of power plants using a diverse mix of fuels – coal, natural gas, nuclear, wind, geothermal and oil, among others. In fact, coal accounts for the largest market share among all fuels used by competitive suppliers. According to EIA data, almost 40 percent of net generation in 2004 from the competitive power sector was coal-based. In 2004, the competitive power industry consumed over 222 million tons of coal, or about one-fifth of all coal production used to generate electricity.

As we are major coal customers, rail fuel surcharges have had a substantial impact on our costs, given the fact that rail is the primary mode of transportation for coal customers. We acknowledge that fuel costs have increased, but want to ensure that those increases are reflected in rail rates in a fair and equitable manner.

EPSA supports the STB's proposals to: link the fuel surcharge more directly to the cost of transport; prohibit the railroads' double charging for fuel increases; use a standard price index that more closely reflects the cost of locomotive fuel; and increase transparency. We believe that the STB should also address the issue of an appropriate base fuel price above which surcharges are imposed, and encourage the STB to take a harder look at market power issues.

Base Fuel Prices

One crucial issue which was raised by shippers at the May hearing which this decision does not address is the base fuel price level above which the surcharge is levied. If the fuel surcharge is indeed a surcharge to account for unanticipated and extraordinary rises in fuel costs, and not a direct fuel pass-through, the base level must be appropriately established. Many railroads had been using a base cost fuel price which is years out of date. Shippers have faced numerous increases in their rail rates in recent years; certainly increasing fuel costs have been factored into these rates. We propose that the STB consider limiting fuel surcharges to account only for fuel price increases either since the last contract was signed or over the prior year. Fuel surcharges can only be fair and

reasonable if the baseline above which they are charged is set at a fair and reasonable level.

Linkage Of Fuel Surcharge To Cost Of Transport

The proposal that fuel surcharges be directly linked to the actual cost of transport via either a mileage-based or ton-mileage based surcharge instead of a base-rate surcharge is an excellent one. One of the problems coal shippers have faced in our attempts to estimate and hedge against increases in the surcharge is the disconnect between fuel cost increases and rail cost increases. Base rates are not necessarily cost-based, and vary depending on individual contracts and the level of competition on a line. The practice of basing fuel cost surcharges on the base rate meant that two coal generators shipping the same tonnage of coal the same number of miles could be charged very different fuel surcharges. A mileage-based system will not only increase the transparency of the fuel surcharge mechanism, it will make it easier for shippers to use hedging mechanisms to address costs by linking rail cost increases more directly to fuel cost increases.

“Double-Dipping”

The prohibition on “double-dipping” by applying a fuel surcharge even when the base rail tariff includes an index such as the Rail Cost-Adjustment Factor (RCAF), is also a good one. Because the RCAF, which is adjusted quarterly, already takes into account increases in fuel costs, railroads over-recover if they charge a separate fuel surcharge in addition to the RCAF.

Diesel Fuel Index

The proposal that all railroads use the Energy Information Administration's "U.S. No. 2 Diesel Retail Sales by All Sellers (Cents per Gallon)" index to measure increases in fuel costs is an improvement over current practice. Presently, some railroads are using diesel fuel prices and some are using crude oil prices on which to base their fuel cost surcharges. The price of crude oil does not completely track the final cost of locomotive diesel, because a large part of the diesel cost is processing cost; hence a 50 percent rise in the price of crude can lead to a smaller increase in diesel costs. However, we would like to point out that the No. 2 Diesel Retail Sales index still does not directly track the prices which railroads pay for their fuel – hedging practices and bulk purchase contracts can result in railroads paying considerably less than this index. The STB should monitor the actual railroad fuel costs and be alert for the possibility of continued over-recovery by the railroads.

Increased Transparency

We support the proposal that each Class I railroad should provide a monthly report to the STB on its fuel costs and fuel surcharge recovery. This information will allow both the STB and shippers to get a more clear picture of fuel costs and recovery. We propose that the STB not consider the fuel surcharge issue a final, settled matter after this decision; instead, this should be looked on as an ongoing, iterative process, with possible further reporting required. Increased transparency could suggest additional ways to deal with shippers' concerns. Also, to the rail industry's credit, railroads' fuel efficiency has been rising: from about 235 ton-miles per gallon of diesel in 1980 to about 410 ton-miles per

gallon in 2004. These monthly reports may reveal current and future trends of rising fuel efficiency and better hedging practices that will lower railroads' fuel costs and allow them to pass these savings on to rail customers. We are concerned, however, that the railroads have less incentive to improve their efficiency if they are able to pass through fuel costs via a surcharge.

Other Issues

We appreciate your consideration of fuel surcharge concerns. Now that you have tackled this issue, we urge you to consider additional concerns we have as shippers. Many power generators are concerned that the limited number of Class I railroads are unable to keep up with demand for timely rail service, and instead are giving greatest priority to the rapidly growing and highly remunerative intermodal shipment market over coal deliveries. The STB should take a harder look at market power issues, rather than focusing solely on railroad cost recovery. The railroads need to continue focusing capital on relieving the areas which are the most congested. The efforts to date are welcome and helpful, but more must be done as electricity demand, and the corresponding use of coal-fueled power, increases. Rail capacity in the Powder River Basin and on routes leading from the area to the rest of the country should continue to be expanded. Transportation rates and terms for imported and domestic coal need to be harmonized, to increase competition and vary the supply sources for coal.

We appreciate the efforts by the STB in this proceeding to address fuel surcharges. We look forward to continuing to work with you to address the needs of electric power customers now and in the future.