
INTEROFFICE MEMORANDUM

TO: CATHERINE DEBO
FROM: ANN GULLICKSON
SUBJECT: POTENTIAL DISCOUNTED FUEL FROM CITGO
DATE: JANUARY 18, 2006

CITGO Petroleum Corporation and Venezuelan government officials have made an offer of discounted diesel fuel to the Chicago Transit Authority (CTA) and may be making similar offers to other large U.S. transit systems. CITGO is also working with communities in the Northeast to provide discounted heating oil. We are not aware of any offers to other large transit systems at this time, nor to any medium-sized transit systems such as Metro Transit (Metro). The question has been raised of whether Madison might be able to benefit from a comparable offer. According to media reports, Chicago's Transit Authority was offered diesel fuel at a 40% discount, on the condition that the savings is passed on to low-income riders through free or reduced fare media. CTA did not accept the offer, but recent media reports indicate that talks are continuing between CTA and CITGO. It is not clear what a 40% discount means. A discount from what price – from the competitive bid of the lowest of other bidders, or from a non-competitive offer by CITGO?

POTENTIAL FOR MADISON

At Metro, we consume 1.3 million gallons of diesel fuel annually. Recent prices (not reflective of the spike following Hurricane Katrina) are \$2.10. A 40% discount would be in excess of \$1 million, assuming it was in place for a full year. Note that this would not help Metro cover its fuel expenses in 2006 (already predicted to exceed its budget), as the Chicago offer was tied to CTA passing all savings along, through reduced fares or by some other means, to low income riders. The City has made some separate provision for reduced fare media for low-income people in its 2006 budget. This would provide additional revenues dedicated for this purpose, which could be attractive to low income riders.

ITEMS TO CONSIDER

1. One of the factors impeding the potential deal in Chicago is that the CTA fleet operates on Ultra Low Sulfur Diesel (ULSD) fuel, and CITGO does not provide ULSD fuel. At Metro Transit, we also operate using ULSD, the cleanest fuel available. Metro switched to ULSD in September 2006 as part of a regionally brokered agreement between the City of Madison and MGE Energy, Inc. in connection with the construction of the West-Side Co-generation Facility – in order to realize the environmental benefits of this cleaner fuel (ULSD) as a partial offset to environmental impacts of the Co-gen plant. As part of the Agreement, Metro is using an MG&E grant to help offset the cost differential between ULSD and conventional diesel until use is required. Transit systems not currently using ULSD are mandated under EPA regulations to use ULSD fuel September 1, 2006.

2. When we switched to ULSD in September 2005, Metro experienced leakage in the fuel lift pumps on 75 buses w/Cummins engines. Other transit systems that have made the transition to ULSD with these engines have experienced the same effect. We were fortunate to be able to have Cummins absorb the cost of replacing the fuel pumps under warranty. If we were to switch back to conventional low sulfur diesel, Cummings warns that we would experience the same problem again. They won't replace fuel pumps again under warranty if we convert from ULSD back to conventional diesel, and then back to ULSD again in September 2006. The cost to Metro would be approximately \$31,000 for parts and labor. This \$31,000 cost would be born by Metro's budget, while any savings from discounted fuel would be passed on to our low-income customers.
3. We have a contract with Harkney Oil Company for Ultra Low Sulfur Diesel (ULSD) fuel that expires June 30, 2006. There is a clause in the contract that allows us to cancel with 30-day notice. When we went out to bid for this contract, CITGO did not produce ULSD fuel. Before terminating the contract with our existing supplier, we would need to know whether CITGO would be able to deliver ULSD in September 2006 to Metro when the new EPA regulations go into effect. If we only have the potential of using CITGO fuel for a few months, the potential savings would be dramatically less and have to be weighed against the impact of alienating vendors who would be involved in a competitive process in the future, as well as the cost for replacing fuel pumps again (as cited in number 2 above).

If the CITGO offer were accepted in lieu of competitive bidding, Metro would be in non-compliance with federal, state, and local regulations. Non-compliance carries serious consequences. Metro relies on substantial federal and state funding (50%) for its operations and capital purchases (80%). Additionally, the value of competitive bidding to Metro's budget, is that competitive bidding brings the best cost per gallon to Metro for its budget.

4. As a final point, we need to remember that this is all speculative. We have not received an offer from CITGO nor know of any other transit systems the size of Metro who have received such offer. We do not know any more about the offer to CTA than what has been reported in the media. However, if we were to be able to consider such an offer, we have begun to identify issues Metro would need to consider in making a determination as noted above.