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BEFORE THE
SURFACE TRANSPORTATION BOARD

KANSAS CITY POWER & LIGHT COMPANY,

Complainant,

v.

UNION PACIFIC RAILROAD COMPANY,

Defendant.

Docket No. 42095



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UNION PACIFIC'S BRIEF IN RESPONSE TO ORDER TO SHOW CAUSE

The Surface Transportation Board should not dismiss this proceeding for lack of jurisdiction pursuant to 49 U.S.C. § 10709. Kansas City Power & Light Company ("KCPL") is challenging certain "Option 2" rates that Union Pacific Railroad Company ("UP") established in UP Circular 111 ("Circular 111"). Option 2 rates are common carrier rates, not contract rates, because UP intended them to be common carrier rates and the elements they contain are permissible elements of common carrier rates.

In the sections below, we explain that UP clearly manifested its intent to establish common carrier rates, not contracts, with customers that ship coal under Circular 111, and that the parties' intent, not the elements contained in a pricing document, determines whether the document establishes common carrier rates or contract rates. We also show that Option 2's elements are consistent with elements contained in documents that establish common carrier rates, including documents that the Board's predecessor has held to establish common carrier rates rather than contracts.

I. BACKGROUND

UP transports most of its Powder River Basin coal pursuant to confidential, long-term contracts. In March 2004, however, UP introduced a new pricing mechanism for PRB coal, which it set forth in Circular 111. The new pricing mechanism reflects a shift in UP's approach to the coal business, away from the use of private contractual transactions and towards the use of common carrier rate schedules. The new mechanism was designed so that UP's customers will understand that their rates, terms, and conditions reflect a fair sharing in the overall financial burden associated with UP's significant coal-related capital needs and to simplify the way that customers do business with UP.

Under Circular 111, UP customers choose between an option that includes no volume commitment (Option 1) and an option that provides different rates if the shipper certifies that its volumes will be within a specified range over a specified period (Option 2). UP has made public Circular 111's terms and conditions.¹ UP customers who ship coal to destinations covered by Circular 111 have access to Circular 111 rate items.

UP designed Circular 111 with the intent that it would establish common carrier rates and service terms, and UP has consistently maintained that Circular 111 rates are common carrier rates, not contract rates.

II. UP'S MANIFESTED INTENT TO ESTABLISH COMMON CARRIER RATES AND NOT CONTRACT RATES THROUGH CIRCULAR 111 PRECLUDES A DETERMINATION THAT OPTION 2 CREATES CONTRACTS.

UP's manifested intent to establish common carrier rates and not to form contracts with customers that ship coal under Circular 111 precludes any finding that Option 2 rates are contract rates that fall outside the Board's jurisdiction pursuant to 49 U.S.C. § 10709.

¹ See <http://www.uprr.com/customers/energy/attachments/circ111.pdf>.

As a matter of basic contract law and Board precedent, the parties' intent determines whether a document that sets forth railroad rates and service terms constitutes a contract or a railroad's fulfillment of its obligation to provide common carrier rates and service terms. *See, e.g., Kan. Power & Light Co. v. Burlington N.R.R.*, 740 F.2d 780, 785 (10th Cir. 1984) ("[T]he controlling question as to whether a binding agreement was entered into is the matter of intent of the parties."); *Aggregate Volume Rate on Coal, Acco, UT to Moapa, NV*, 364 I.C.C. 678, 689 (1981) ("We will examine the record on a case-by-case basis to determine objectively manifested intent.").

The parties' intent is crucial because it is the only definitive way to distinguish between common carrier rates and contract rates. The Board observed in its Show Cause Order that Option 2 rates have "some of the indicia of a contract." *Order* at 1. However, "[i]t is not surprising that [Option 2 rates] have many, if not all, of the elements of a lawful contract, as a tariff is nothing more than a special kind of contract between a carrier and its shippers." *Nat'l Grain & Feed Ass'n v. Burlington N.R.R.*, 8 I.C.C.2d 421, 437 (1992), *aff'd in relevant part, rev'd on other grounds sub nom. Nat'l Grain & Feed Ass'n v. United States*, 5 F.3d 306 (8th Cir. 1993). Thus, it is the parties' intent, not the elements contained in a pricing document, that determines whether the document establishes common carrier rates or contract rates.

UP clearly manifested its intent to establish common carrier rates, and not to enter into rail transportation contracts, in several ways:

First, Circular 111 states on its face that it is a "Common Carrier Circular." The document does not mention 49 U.S.C. § 10709 or otherwise purport to create a contract pursuant to 49 U.S.C. § 10709. By contrast, UP's contracts for non-exempt commodities such as coal typically make express reference to 49 U.S.C § 10709. The Board has relied on such express

references when determining whether specific movements were made as common carriage or under contract. *See, e.g., Cross Oil Ref. & Mktg. v. Union Pac. R.R.*, STB Finance Dkt. No. 33582 (STB served Oct. 27, 1998) (holding that UP provided transportation under contract because shipments moved under the terms of a document that stated, “This Contract is made pursuant to 49 U.S.C. 10709 . . .”).

Second, UP has expressly stated its intent that Circular 111 rates and terms constitute common carrier offerings rather than contractual arrangements in response to shippers’ inquiries. Specifically, UP has told shippers and their representatives that shippers that execute a “Volume Commitment Certificate” to ship under Option 2 would not forfeit their right to challenge Option 2 rate and service terms on the grounds that their execution of the commitment certificate created a contract subject to 49 U.S.C. § 10709.²

Third, UP has made clear to shippers in the process of discussing Circular 111 rates and service terms that the rates and terms are not “‘arrived at through mutual agreement,’” which Board precedent requires for a “contract rate.” *Order* at 1-2 (quoting former 49 C.F.R. § 1039.1). UP establishes Circular 111 rates and service terms unilaterally. Of course, UP takes into account the views and needs of its customers, and it has occasionally adjusted Circular 111 rates and service terms in response to customer feedback, but UP takes a similarly reasonable approach to its other common carrier pricing documents. UP has made clear to customers that Circular 111 rates and terms will ultimately reflect its own determination regarding appropriate rate levels and service terms. UP’s customers understand that Option 2 rates and service terms

² *See, e.g.,* KCPL Complaint at 5 (“UP has represented that Option 2 rates under Circular 111 are common carrier rates . . .”); UP Answer at 4 (“UP further admits that it has represented that Option 2 rates are common carrier rates, and that it has represented that a shipper’s execution of a ‘Volume Commitment Certificate’ does not create a contract under 49 U.S.C. § 10709.”).

are established unilaterally by UP and are not the product of an agreement between any specific customer and UP.³

UP expects KCPL to explain that it did not intend to enter into a contract with UP, consistent with KCPL's allegations in its Complaint.⁴ The Board need not inquire into KCPL's intent, however, because a railroad and a shipper can enter into a rail transportation contract only by mutual agreement, and UP clearly did not intend to enter into contracts through Option 2 rates. Board precedent recognizes that rail carriers have the right to choose whether to establish rates as common carrier rates, even when they could have offered them as contracts. *See Nat'l Grain & Feed*, 8 I.C.C.2d at 438.

* * *

A railroad and a shipper may enter into a rail transportation contract only by mutual agreement, and UP had no intent to form a contract with KCPL or any other party that ships under Circular 111. In the next section, we show that the elements of Option 2 that the Board identifies as "indicia of a contract" are consistent with elements that appear in common carrier rates. The determinative point that prevents Option 2 rates from being contract rates, however, is that they lack the one essential feature of every contract – the mutual intent necessary to form a contract.

³ Option 2 rates would still be common carrier rates even if the shipper-specific rate levels had been mutually agreed upon between UP and the shippers to which the rates apply. *See Nat'l Grain & Feed*, 8 I.C.C.2d at 437 ("Rail carriers have long followed the practice of incorporating rates they have negotiated with shippers into tariffs.").

⁴ *See, e.g.*, KCPL Complaint at 4 (describing the "terms of Circular 111" as being "set unilaterally by UP"); *id.* at 6 (stating that "Circular 111 rates were not the product of any agreement between KCPL and UP").

III. THE ELEMENTS CONTAINED IN OPTION 2 RATES ARE PERMISSIBLE ELEMENTS OF COMMON CARRIER RATES.

Option 2's provisions fall comfortably within the scope of permissible common carrier offerings. The Board stated in its Show Cause Order that Option 2 rates have some of the "indicia of a contract" because the rates are based on a volume commitment, shippers provide a signed acknowledgement of the applicable terms and conditions, payments are due if the shipper or carrier fails to meet its commitments, and Option 2 contains a *force majeure* clause. *Order at* 1. In fact, Option 2's provisions are modeled on provisions contained in documents that have been held to establish common carrier rates and service terms rather than contracts.

The Interstate Commerce Commission ("ICC") addressed a tariff that shared many of the important features of Option 2 rates in *Aggregate Volume Rate on Coal, Acco, Utah to Moapa, Nevada*, 364 I.C.C. 678 (1981). In that rate reasonableness case, the agency held that a shipper's written commitment to a volume agreement, accompanied by a bond for payment of any shortfall, did not reflect the shipper's intent to "accept" a "contract rate." The ICC observed that the arrangement was neither unusual nor inconsistent with the existence of common carrier rates. It explained:

"[T]he alleged 'acceptance' . . . was required by the terms of a common carrier tariff. It is not unusual to find an indemnity bond and notification requirement in on [sic] annual volume rate tariff. This often reflects carrier uncertainty that the requisite volume will be tendered The bond covers the difference between the annual volume and 'fallback' rates, and the written assurance of tender appears to ease any difficulty in collecting the bond should the need arise." *Id.* at 689.

The ICC further explained that the written assurance could not be viewed as acceptance of a contract because the shipper essentially had no choice: had the shipper refused

to provide the written assurance, a higher rate would have applied. *Id.*⁵ Customers that want to ship under Option 2 face the same alternative.⁶ Thus, under Board precedent, neither Option 2's terms and conditions nor a shipper's written acknowledgement of those terms and conditions create a rail transportation contract pursuant to 49 U.S.C. § 10709.

The ICC did not address the use of a *force majeure* clause in *Aggregate Volume Rate*, but there is nothing unusual about a common carrier tariff that includes a *force majeure* clause. In fact, most of UP's common carrier rates incorporate UP Tariff 6007-B, "Governing Rules for Regulated Traffic," which includes a *force majeure* clause that is similar to the clause in Option 2.⁷ Notably, Tariff 6007-B's *force majeure* clause, like the *force majeure* clause in Option 2, provides that shippers' volume commitments are reduced during a *force majeure*, which reinforces the fact that common carrier tariffs frequently establish reduced rates in exchange for volume commitments.⁸

Option 2 rates would be common carrier rates even if the "indicia of a contract" identified by the Board in its Show Cause Order were not present in other common carrier rates. As the ICC has explained, "the ratemaking flexibility advocated by the Staggers Act gives rail carriers the freedom to explore new transportation programs and services without the need to

⁵ Rail carriers have a long-established practice of establishing common carrier tariffs that provide reduced rates conditioned on aggregate tonnage delivered during a specified period. *See, e.g., Coal to New York Harbor Area*, 311 I.C.C. 355 (1960).

⁶ KCPL Complaint at 6 ("KCPL was electing the Option 2 rates as the only alternative to the even higher Option 1 rate . . .").

⁷ *See* UP Tariff 6007-B, "Governing Rules for Regulated Traffic" Item 295, *available at* <http://www.uprr.com/customers/ind-prod/pdf/UP6007BOOK.pdf>.

⁸ *See* UP Tariff 6007-B, Item 295 ("For purposes of determining 'shipper' volume commitment, for a period in which 'force majeure' is invoked, the volume requirement shall be reduced by 1/361 for each day that 'shipper' is prevented by the 'force majeure' from tendering traffic under this agreement.").

receive regulatory approval.” *Nat’l Grain & Feed*, 8 I.C.C.2d at 439. Unless a specific prohibition applies, a rail carrier “may establish any rate for transportation or other service provided by the rail carrier.” 49 U.S.C. § 10701(c). Rail carriers thus have broad flexibility to design common carrier offerings as alternatives to rail transportation contracts in response to business needs. *See Nat’l Grain & Feed*, 8 I.C.C.2d at 439. UP’s Option 2 rates do not contain any elements that are prohibited under the Interstate Commerce Act.

IV. CONCLUSION

Option 2 rates are common carrier rates because UP intended them to be common carrier rates and they do not contain any prohibited elements.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that on this 25th day of September, 2006, I caused a copy of Union Pacific's Brief in Response to Order to Show Cause to be served by hand on Kelvin J. Dowd of Slover & Loftus, 1224 Seventeenth Street, N.W., Washington, D.C. 20036.

A handwritten signature in black ink, appearing to read "Michael L. Rosenthal", written over a horizontal line.

Michael L. Rosenthal