

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 669

INTERPRETATION OF THE TERM "CONTRACT" IN 49 U.S.C. 10709

COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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Union Pacific Railroad Company ("UP") hereby submits comments in connection with the Surface Transportation Board's ("STB" or "Board") notice of proposed rulemaking served March 29, 2007 ("March 29 decision"), in the above captioned proceeding. This proceeding raises important issues concerning commercial arrangements between railroads and their customers, and UP appreciates the opportunity to address these issues.

I. OVERVIEW OF THE BOARD'S PROPOSAL

In its March 29 decision, the Board specifically asks for comments on its proposal to interpret the term "contract" in 49 U.S.C. 10709 as:

"embracing any bilateral agreement between a carrier and a shipper for rail transportation in which the railroad agrees to a specific rate for a specific period of time in exchange for consideration from the shipper, such as commitment to tender a specific amount of freight during a specific period or to make specific investments in rail facilities."

The Board states in its decision that this proposal stems from its concerns about a lack of "any clear demarcation between contract and common carrier rates."

It further indicates that this lack of demarcation has permitted the establishment of "hybrid" arrangements such as UP's Circular 111 that are termed tariffs but in the Board's view look like contracts. The March 29 decision suggests that such "hybrids" do not enjoy the confidentiality that contracts do and thus "could create an environment where collusive activities in the form of anticompetitive price signaling could occur."

The Board's proposed definition is presumably intended to ensure that any price document, such as Circular 111, which establishes a bilateral obligation, such as a volume or service commitment, would be considered a contract and not a common carrier rate regardless of the intent of the parties. The Board presumably anticipates that its proposal, if adopted, will result in fewer common carrier price documents and therefore less transparency in pricing.

II. SUMMARY OF UP'S POSITION

UP's comments will demonstrate that the Board's proposal lacks foundation in fact or law; represents unsound public policy that will call into question valid commercial arrangements, thereby creating confusion and uncertainty; and will stifle appropriate marketplace innovation. UP urges discontinuance of the rulemaking and a return to the status quo, in which the intent of the parties is controlling as to whether a Section 10709 contract is formed. The next best alternative would be the adoption of a definition that would declare that a contract is determined solely on the intent of the parties.

III. THE BOARD'S PROPOSAL IGNORES THE LAW AND POLICY ASSOCIATED WITH THE AUTHORITY FOR RAILROADS TO CONTRACT.

Contracting is based on mutual assent, but the Board's definition would override this legal principle by regulation. In defining the elements of a rail contract, the Board's proposal does reflect a general notion of mutual assent. However, rather than relying on the

parties to define when mutual assent exists to create a Section 10709 contract in whatever way they choose, the Board by regulation would define a Section 10709 contract based on the substantive terms of a particular pricing arrangement, regardless of whether there was mutual assent to create such a contract. Ignoring the intent of the parties in this way is inconsistent with basic notions of contracting.

Under fundamental principles of general contract law, a contract is based on the mutual assent of the parties. In *Specht v. Netscape Communications Corp.*, 306 F.3d 17, 29 -30 (2d Cir. 2002), the court stated that: "Mutual manifestation of assent, whether by written or spoken word or by conduct, is the touchstone of contract. *Binder v. Aetna Life Ins. Co.*, 75 Cal.App.4th 832, 848, 89 Cal.Rptr.2d 540, 551 (1999). Additionally, in *ATACS Corp. v. Trans World Communications, Inc.*, 155 F.3d 659, 665 - 66 (3d Cir. 1998), the Court stated that:

While typically analyzed in terms of offer and acceptance, *see* 1 Arthur L. Corbin, *Corbin on Contracts* § 12, at 27 (1963), the decisive inquiry in contract formation is the "manifestation of assent of the parties to the terms of the promise and to the consideration for it..." 1 Samuel Williston, *A Treatise on the Law of Contracts* § 23, at 51 (Walter H.E. Jaeger ed., 3d ed.1957); Restatement (Second) of Contracts § 22 (1981) ("Restatement").

The concept of mutual assent has been discussed by a number of state courts as well. The Supreme Court of Alabama has held: "The requisite elements of a contract include: an offer and an acceptance, consideration, and mutual assent to terms essential to the [formation of a contract]." *Lyles v. Pioneer Housing Systems, Inc.*, 858 So.2d 226, 229 (Ala. 2003) (citations omitted). Likewise, the Court of Special Appeals of Maryland has held: "An essential element with respect to the formation of a contract is 'a manifestation of agreement or mutual assent by the parties to the terms thereof; in other

words, to establish a contract the minds of the parties must be in agreement as to its terms.”

Mitchell v. AARP Life Ins. Program, New York Life Ins. Co., 779 A.2d 1061, 1069 (Md. 2001) (citations omitted).

The Board’s proposal also runs counter to the policy of flexibility and innovation embodied in the statute that the Board implements. Neither railroad common carrier rates nor contracts are defined by the type of terms included. Rather, as with general contract law, the intent of the parties has dictated whether an arrangement is a contract.

The relevant case law under the statute reinforces the principle that 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. “. . . 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.

The Board's proposal would seem to turn past precedent and practice on its head. It in effect would take rail commercial arrangements out of the marketplace and the hands of the parties and place them in a world where their contours are defined by the Board and regulation – exactly what was not intended by Congress when it passed the Staggers Act. The Board's proposal would clearly turn the regulatory clock back.

IV. THE BOARD'S PROPOSAL ALSO MISINTERPRETS BASIC RATEMAKING PRINCIPLES EMBODIED IN THE STATUTE.

A. THE BOARD QUESTIONS ANY COMMON CARRIER RATE THAT HAS VOLUME COMMITMENTS AND OTHER TERMS CONTRARY TO SETTLED PRECEDENT AND PRACTICE.

In support of its proposed definition, the Board argues that arrangements such as Circular 111 that include special levels of services should be considered Section 10709 contracts and not common carrier rates based on their terms. But precedent and practice suggest otherwise.

Circular 111's Option 2's provisions fall comfortably within the scope of permissible common carrier offerings. The Board has stated 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. 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 intended to ease any difficulty in collecting on 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.*¹ Customers that want to ship under Option 2 face the same alternative. 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 2.² Notably, Tariff 6007-B's *force majeure* clause, like the

¹ 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).

² See UP Tariff 6007-B, "Governing Rules for Regulated Traffic" Item 295, available at <http://www.uprr.com/customers/ind-prod/pdf/UP6007BOOK.pdf>.

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.³

Option 2 rates would be common carrier rates even if the "indicia of a contract" identified by the Board 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 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 law.

B. THE BOARD ALSO SUGGESTS, COUNTER TO PRECEDENT, COMMON SENSE, AND SOUND POLICY THAT ARRANGEMENTS SUCH AS CIRCULAR 111 CANNOT BE COMMON CARRIER RATES BECAUSE THE RAILROAD CAN ONLY CONTROL THE LEVEL OF THE RATE AND NOT THE DESIGNATION OF THE RATE.

The Board suggests that a railroad cannot determine the designation of a commercial arrangement as a common carrier or contract rate. But under settled law, a rail carrier has the right to establish a common carrier rate and related terms of transportation.

³ 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.").

Under 49 U.S.C.10701(c), "a rail carrier may establish any rate for transportation or other service." Contrary to established precedent, the Board interprets this provision of the statute as meaning that a rail carrier can only designate the level of rate, not the type of rate or the terms of the services included in the rate. Under this provision, railroads are entitled to the route and rate initiative, which allows carriers in connection with a through route to specify the point of interchange and the form of the rate (whether it be joint, combination, proportional, or local). *Central Power & Light v Southern Pacific*, 1 STB 1059 at 1064 (1996), 2 STB2d 235 at 238, 248 (1997), *aff'd MidAmerica Energy Co. V STB*, 1099 F 3rd 1099 at 1106-09 (8th Cir 1999). The Board's view that a carrier can only designate the level of a rate is clearly inconsistent with this precedent.

Furthermore, the Board's position belies common sense and sound policy. A contract by its nature requires agreement between the parties. Thus, a railroad cannot designate an arrangement as a Section 10709 contract if there is no mutual assent to create such a contract. Absent that assent, such an arrangement for a regulated commodity is a common carrier rate. So, the railroad has no choice if there is no agreement but to call the rate a common carrier rate.

V. THE BOARD'S PROPOSAL ERRONEOUSLY ASSUMES THAT COMMON CARRIER PRICING IS INHERENTLY ANTICOMPETITIVE.

A. PUBLIC PRICING IS A LEGITIMATE COMMERCIAL PRACTICE.

The Board's proposal apparently stems from a concern that, after a quarter of a century since Congress authorized rail transportation contracts, the lack of a specific definition of what constitutes a contract has created a situation in which arrangements that should be termed contracts are considered common carrier rates. And given that common carrier rates are subject to some disclosure, and contracts are generally kept confidential, the

Board believes that increased use of common carrier price documents will result in more transparency. Because the Board believes that transparency breeds price signaling, common carrier price documents, in the Board's view, creates more opportunity for anticompetitive conduct. UP respectfully disagrees that the Board's concerns are warranted.

The Board's assumption about the negative effect of public pricing does not accurately reflect how this issue is analyzed under the antitrust laws. The U.S. Supreme Court has stated that:

the exchange of price data and other information among competitors does not invariably have anticompetitive effects; indeed such practices can in certain circumstances increase economic efficiency and render markets more, rather than less, competitive. For this reason, we have held that such exchanges of information do not constitute a *per se* violation of the Sherman Act.

United States v. United States Gypsum Co., 98 S.Ct. 2864, 2875, fn 16 (1978). Similarly, in considering a proposal for publication of exempt rail rates, the U.S. Department of Justice (DOJ) has stated:

"The Division views rate publication as a useful function which enhances rather than decreases the efficiency of a competitive market. By tabulating and disseminating available transportation rates, a publication service provides a ready source of information that may facilitate 'comparison shopping' for the best available price and service option and allow carriers to inform perspective customers of their prices and conditions of service."

See, DOJ Business Review Letter involving the Western Railroad Traffic Association (WRTA), 1983 WL 45985. DOJ's position was reaffirmed in a later business review letter involving WTRA and similar issues. *See DOJ Business Review Letter*, 1993 WL 463775.

Public pricing is not *per se* anticompetitive, and the Board should not base any action here on that blanket assumption. Public pricing is a perfectly legitimate business practice.

B. UP'S CIRCULAR 111 IS A VALID COMMON CARRIER PRICE DOCUMENT THAT DOES NOT REVEAL PRICES PUBLICLY.

With particular respect to UP's Circular 111, contrary to what the Board might think, this circular was an innovative effort to simplify how UP did business with its SPRB customers while continuing to offer unit train transportation that met their needs. While complying with the Board's regulations on disclosing common carrier rates on request, Circular 111 does not reveal UP's rates to UP's competition.

First, Circular 111 is a common carrier arrangement whose rates are disclosed only to those who are covered by the rate document. UP used a common carrier price document to facilitate its efforts to simplify and to communicate its product to UP customers effected by Circular 111. Attachment A goes into more detail about the commercial reasoning behind and the elements of Circular 111.

Second, Circular 111 includes terms that are within the scope of permissible common carrier offerings and also reflect adherence to the law as express in various statutory and regulatory provisions. For example, the committee certificate under Option 2 indicating acceptance of the rates and other terms documents that the Option 2 rates are "released value" rates under the Carmack Amendment. Under 11706(c)(1)(3)(A), a "released value" arrangement requires agreement either "by written declaration of the shipper or by written agreement between the shipper and the carrier." The signed certificate is intended to serve as that agreement.⁴ Likewise, volume requirements such as those found in UP's Circular 111 have been found legitimate in other common carrier pricing

⁴ In order words, under the Board's proposal, the written declaration or agreement the law requires for common carrier, released value rates will automatically transform those rates into Section 10709 contracts, a result which makes no sense and cannot possibly be reconciled with the statute.

arrangements. See, Section IV.A. The Board should not take action based on a misguided belief that such arrangements are suspect.

VI. COUNTER TO SOUND REGULATORY POLICY, THE BOARD'S PROPOSAL PUT THE FREEDOM TO CONTRACT AT RISK AND WOULD CALL INTO QUESTION LEGITIMATE COMMERCIAL ARRANGEMENTS THAT REFLECT THE INTERESTS OF BOTH CARRIERS AND CUSTOMERS.

The Board has proposed a definition of the term "contract" that is very specific. In proposing this definition, the Board indicates that it is interested in ensuring that arrangements, considered today to be tariffs, are considered to be contracts, with their attendant confidentiality. In the Board's view, more confidentiality means less opportunity for collusive conduct.

By arbitrarily restricting contracts to a "bilateral agreement between a carrier and a shipper. . . in which the carrier agrees to a specific rate for a specific period of time in exchange for consideration for the shipper", the Board is arbitrarily restricting contracts to only specific terms and specific circumstances only. The Board's proposal would, thus, appear to make invalid many otherwise legitimate contractual arrangements that would not fit the specific elements of its proposed definition. There are numerous legitimate "unilateral" contract arrangements in place today which the parties intended to be Section 10709 contracts but which would not be considered Section 10709 contracts under the proposed definition. Likewise there are common carrier rates in place today that include volume commitments or other terms traditionally found in tariffs that would be considered contracts under the definition, again counter to what the parties might intend.

UP, for example, has contractual arrangements that run the gamut. It has entered into over 18,000 Section 10709 contracts in the 12 years since the ICC Termination Act which the Board would consider to be "unilateral" contracts because they provide for

acceptance by performance (typically by tender of traffic under the terms of the contract) and can be unilaterally cancelled by UP on short notice (typically 30 days). UP and its shippers have successfully conducted business in this way for years, and these arrangements have allowed UP to compete with the truckers, who can provide transportation arrangements in a totally deregulated environment. In addition, there are contracts that incorporate common carrier terms by reference. The agency's proposed definition seems to be saying that such arrangements would no longer be considered Section 10709 contracts.

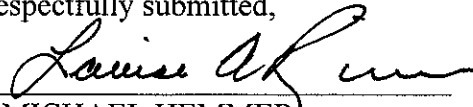
The straightjacket and arbitrary approach of the Board's proposal thus could create confusion and uncertainty about existing arrangements and discourage carriers and shippers from entering into more flexible and innovative arrangements that better reflect the intent of the parties in the marketplace. If adopted, the Board's proposal could very well result in common carrier arrangements becoming more barebone and less innovative to the detriment of carriers and customers alike. Likewise, the Board's proposal could complicate simple unilateral contracts by raising concerns that to be valid a Section 10709 contract must be bilateral. The Board surely cannot intend this result.

VII. CONCLUSION

UP urges the Board to discontinue its rulemaking and maintain the status quo. Its action is based on an assumption that common carrier pricing is *per se* anticompetitive, a conclusion that is not consistent with antitrust principles, accepted commercial practice or the statute the Board administers. And its proposed remedy is not founded in the law or sound policy. In the alternative, the Board should define a Section 10709 contract based on what both parties to the arrangement intend. Such an approach would be consistent with basic principles of contracting and the overarching deregulatory focus of the statute. Any other approach would call into question, for no valid reason, legitimate commercial arrangements that have been business practice for years, creating unnecessary confusion and

uncertainty. The Board must not act in a way that removes the ability of railroads to respond to the marketplace with minimal regulatory oversight, as envisioned by the statute.

Respectfully submitted,



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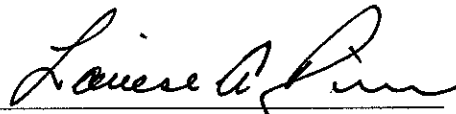
*Attorneys for Union Pacific Railroad
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June 4, 2007

CERTIFICATE OF SERVICE

I certify that I have served a copy of the foregoing document to all parties of record in this proceeding. Service was made by first-class United States mail with postage prepaid.

DATED at Omaha, Nebraska, this 4th day of, 2007.



Louise A. Rinn

Attachment A

Background on UP's Circular 111

CIRCULAR 111 COMPONENTS AND DISTRIBUTION

UP introduced a new pricing mechanism for coal shipped from the Southern Powder River Basin (SPRB) in Wyoming in UP Circular 111, which went into effect March 31, 2004. Circular 111 presents an option that includes no volume commitment (Option 1), or 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).

Circular 111 consists of (1) public standard terms and conditions and (2) limited-disclosure rate items applicable to specific destinations covered by the circular. The rate items include the rate and associated volume requirements, if any. UP discloses the rate items only to customers who ship coal to destinations covered by Circular 111. Other rail carriers have access only if they are a party to a joint rate and, even then, only to the rate item for that joint rate. UP has not granted, and has no intention of granting, BNSF Railway Company access to any Circular 111 rate item.

COMMERCIAL REASONS FOR COMMON CARRIER DOCUMENT

A common carrier format that UP could implement by its own direct action was the method best-suited to achieve two commercial objectives: simplification and customer-communication. First, UP desired to reduce the administrative burdens associated with (a) negotiating detailed and idiosyncratic coal transportation contracts with individual customers and (b) administering a wide array of different contractual provisions. UP's individual contracts had similar but distinct provisions on many important topics that proved quite labor-intensive to negotiate, implement, and administer. For example, contracts varied

in small but material ways regarding when rates would be adjusted and the adjustment formulae to apply, whether there were floors or caps applicable to rate adjustments, whether rate adjustments could be “banked,” what accessorial charges would apply and whether those charges would be adjusted, how cycle-time performance standards would be applied, and how compliance with minimum or maximum volume requirements would be assessed. Negotiating, drafting and administering such complicated terms that differed from contract to contract came to absorb substantial resources, but delivered no commensurate benefits. Adopting a common carrier pricing mechanism was the logical method to standardize the terms and conditions for unit train transportation to SPRB customers.

Second, the common carrier format delivered another benefit: clear communication to UP customers. UP regarded it as vital that its customers – which had become accustomed to negotiating individualized and confidential long-term contracts – both understand UP’s change in business approach and have the assurance that going forward they would not be at a commercial disadvantage if they no longer had a UP contract. UP wanted to be able to communicate in an efficient manner the services it was willing to provide and the costs of those services, while at the same time credibly demonstrating that none of its customers was being asked to shoulder a disproportionate share of the burdens of supporting a coal transportation network, or to forgo a “better deal” made available to other UP customers. UP specifically wished to avoid a major shortcoming with confidential transportation contracts: prospective customers tended to receive a wide array of misinformation from third parties (e.g., economic consultants and shipper trade groups) about the level of rates that UP was offering, but UP was unable to communicate openly or credibly about those issues because of the confidentiality of the rates and other terms in its contracts. Such

misinformation and the false expectations they created had in some instances led to rate reasonableness litigation or misrepresentations regarding contractual provisions in other Board proceedings.