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June 4, 2007

VIA ELECTRONIC FILING

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0001

Re: STB Ex Parte No. 669 – Interpretation of the Term “Contract” in 49 U.S.C. 10709

Dear Mr. Williams:

In accordance with the Board's Decision issued March 29, 2007, in the above-referenced proceeding, enclosed for filing are the “Comments on Proposed Rulemaking of Edison Electric Institute.”

Please note that as of today, our address has changed to that shown above.

Respectfully submitted,



Michael F. McBride

Counsel for Edison Electric Institute

Enclosure

cc: All Parties of Record

**UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 669

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

**COMMENTS ON PROPOSED RULEMAKING
OF EDISON ELECTRIC INSTITUTE**

Pursuant to the Decision of the Surface Transportation Board ("STB" or "Board") served March 29, 2007 in this proceeding, Edison Electric Institute ("EEI") hereby submits its opening comments.

EEI's Interest

EEI is the association of U.S. shareholder-owned electric companies. Its members serve 95% of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70% of the U.S. electric power industry. It also has as Affiliate members more than 65 International electric companies and, as Associate members, more than 170 industry suppliers and related organizations.

Electric energy is the life-blood of the economy in the 21st Century. Without reliable electric supplies, the technical advancements in medicine, automobiles, computing, communications and biotechnology that society takes for granted, would be difficult to imagine. Today, coal represents more than 50% of the fuel used for the production of electricity and is expected to do so at that level for the foreseeable future. Most of that coal moves from mine to power plant, in whole or in part, by rail. Rail rates constitute a large percentage of both the delivered cost of coal (in the case of Powder

River Basin ("PRB") coal, often well over 50 percent of the delivered cost), and of the cost of electricity to the consumer. It is therefore important that the Board maintains vigilant oversight of rail rates for coal and other commodities as to which there is limited or no effective competition for the transportation involved. At issue herein are certain rates for the transportation of coal from the PRB to generating stations owned or operated by EEI's members (among others).

Background on Notice of Proposed Rulemaking

On March 29, 2007, the Board issued a Notice of Proposed Rulemaking ("NPR") herein, requesting comments on a proposed interpretation of the term "contract." In its NPR, the Board stated that it "seeks public comments on a 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 a commitment to tender a specific amount of freight during a specific period or to make specific investments in rail facilities."¹

The NPR stemmed from a complaint filed by Kansas City Power & Light ("KCPL"), in which KCPL claimed that it agreed to the PRB coal shipment rates specified in "Option 2" of Union Pacific Railroad Company's ("UP") "Circular 111" rate publication "under duress" and that those rates "were not the product of any agreement between KCPL and UP; that KCPL does not consider those rates to be reasonable...and that KCPL's execution of the Certificate was specifically conditioned on the understanding that the Option 2 rates and related service terms are common carrier rates

¹ *Interpretation of the Term "Contract" in 49 U.S.C. 10709*, STB Ex Parte No. 669, at 1 (STB served March 29, 2007).

and practices, fully subject to the jurisdiction of this Board as to their reasonableness."² Both KCPL and UP asserted that the Option 2 rates were common carrier rates, not contract rates, and should thus be subject to the Board's jurisdiction. When acting upon KCPL's Complaint, however, the STB stated that the agreement "has some of the indicia of a *contract*: set rates for a term of 3 years, a minimum-volume requirement for KCPL, a service commitment for UP, a liquidated damage provision if either party fails to meet its obligations under the agreement, and a *force majeure* clause."³ If, as the STB suggested, the Option 2 agreement could constitute a contract instead of a common carrier tariff, the STB would have no jurisdiction to hear KCPL's rate complaint.

In *KCPL*, the STB rejected arguments made by KCPL and UP that their intent to enter into a common carrier rate precluded the Option 2 agreement from forming a contract rate.⁴ However, the STB made a limited finding that, in that circumstance, UP's and KCPL's reasonable reliance on agency precedent should govern the STB's decision to exercise jurisdiction (as opposed to the parties' intent), and thus determined that "the parties could reasonably have concluded that entering into the sort of agreement reflected by Option 2 would not preclude review of the reasonableness of the challenged rate by this agency."⁵ While the STB opted to exercise jurisdiction over that Option 2 agreement, it expressed concerns over the implications of the type of agreement at issue:

In contrast with this hybrid pricing mechanism, the terms and conditions in rail transportation contracts are to be confidential, which this agency has recognized

² Verified Complaint of Kansas City Power & Light Company, *Kansas City Power & Light Co. v. Union Pacific Railroad Co.*, STB Docket No. 42095, at 6-7 (filed Oct. 12, 2005) ("KCPL Complaint").

³ *Kansas City Power & Light Co. v. Union Pacific Railroad Co.*, STB Docket No. 42095, at 1 (STB served July 27, 2006) (emphasis added).

⁴ *Kansas City Power & Light Co. v. Union Pacific Railroad Co.*, STB Docket No. 42095, at 3 (STB served March 29, 2007) ("KCPL") (citing *Weinberger v. Bentex Pharms., Inc.*, 412 U.S. 645, 652 (1973) and *Columbia Gas Transmission Corp. v. FERC*, 404 F.3d 459, 463 (D.C. Cir. 2005)).

⁵ *Id.*

as one factor that makes collusion in a highly concentrated industry more difficult. There is thus a significant question as to whether treating such pricing arrangements as establishing common carrier rates may frustrate Congressional intent. Moreover, under the carrier's interpretation of its choice of rate formats, the contract provision in section 10709 would become almost superfluous. There would appear to be no type of "agreement" between the carrier and a shipper – no matter how long the term or how individualized or how bilateral the responsibilities created – that the carrier could not unilaterally label a "common carrier rate" rather than a contract.⁶

In addition to the concerns explained in the simultaneously-issued *KCPL* order, the STB stated its concern in the NPR that "the increased use of these hybrid pricing mechanisms could create an environment where collusive activities in the form of anticompetitive price signaling could occur."⁷ Thus, the STB asked for comments on these concerns by June 4, 2007.⁸

Argument

EEI applauds the STB's concerns about anti-competitive behavior and the need to act within the authority granted to the Board by Congress. However, EEI believes that any interpretation of the term "contract" under 49 U.S.C. § 10709 must take into consideration the facts that surround the formation of any agreement for service, as the STB's recent decision on UP's Petition for Declaratory Order regarding Option 2 provides.⁹ In that decision, the STB refused to issue a blanket declaratory order with respect to whether UP's Option 2 rates under Circular 111 would always be contract or common carrier rates, because it lacked "evidence of the facts surrounding the execution of each particular Option 2 agreement."¹⁰ The facts surrounding the execution of

⁶ *Id.* at 4.

⁷ *Id.* at 4.

⁸ *Id.* at 1.

⁹ *Union Pacific Railroad Co.*, STB Finance Docket No. 42095, at 3 (STB served May 17, 2007).

¹⁰ *Id.*

agreements for service are, in fact, fundamental to understanding whether those agreements result in contract rates or common carrier rates.

A most basic requirement of contract formation is the "meeting of the minds" of the parties to that contract.¹¹ Without such a "meeting of the minds," courts have typically found that a contract does not exist.¹² A "meeting of the minds" is accomplished through the negotiation and acceptance of the terms of the contract by the parties. Tariffs for common carrier service are, however, unique in that they do not offer the shipper the ability to negotiate certain fundamental aspects of the agreement, such as the rate to be charged for the service. The shipper must choose between agreeing to the service at the published rate and not taking service, but the shipper has no ability to negotiate the rate for that service. This "take it or leave it" agreement has often been referred to as a type of "contract of adhesion," which have historically been subject to heightened scrutiny by courts due to the potential that the agreement will be unconscionable.¹³

While the STB decided to exercise jurisdiction over the agreement in *KCPL* because of the parties' "reasonable reliance" that the agreement constituted a common carrier rate agreement, the STB could well have reached the conclusion that it should have exercised jurisdiction because the agreement at issue shared the most fundamental characteristic of all common carrier tariffs: the "take it or leave it" rate that made the

¹¹ *Mutual Life Ins. Co. of New York v. Young's Adm'r*, 90 U.S. 85, 107 (1874).

¹² E.g., "To create a binding contract, there must be a manifestation of mutual assent sufficiently definite to assure that the parties are truly in agreement with respect to all material terms." *Express Indus. & Term. Corp. v. N.Y. State Dep't of Transportation*, 93 N.Y.2d 584, 589 (1999), cited with approval in *Tractebel Energy Marketing, Inc., now known as Suez Energy Marketing, Inc. v. AEP Power Marketing, Inc.* No. 05-4985, et al. (2nd Cir., May 22, 2007), slip op. at 7.

¹³ See, e.g., Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv.L.Rev. 1173, 1179-80 (1983); Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S.Cal.L.Rev. 1, 12-13 (1974); K. Llewellyn, *The Common Law Tradition* 370-71 (1960).

agreement a contract of adhesion. The KCPL-UP agreement had some characteristics that are typically associated with non-tariff contracts (e.g., specification of volumes and duration of service), as the STB noted in its NPR and in the *KCPL* decision, but it still contained the fundamental "take it or leave it" fixed rate characteristic of a common carrier tariff. Had KCPL and UP negotiated at arms' length the rate and other terms for service under Option 2, there could be no question that there was a "meeting of the minds" with respect to the most fundamental aspects of that agreement and that the agreement constituted a contract. But the rate at issue in *KCPL* (and perhaps other terms) were fixed by UP, absent any negotiation with KCPL, as is the case with all tariff rates (and as is perhaps not the case with non-tariff rate agreements). Thus, in the instance of the Option 2 agreement between KCPL and UP, the common understanding of tariffs versus contracts would warrant a determination that the rate at issue was a common carrier rate.

Despite the "take it or leave it" nature of all tariff rates, in some instances shippers may have actual power to negotiate alternate rates or terms of service that make the ultimate agreement between the carrier and shipper more akin to a negotiated contract than a tariff (or contract of adhesion). Unlike in *KCPL* (where the shipper felt forced to take a rate increase under Option 2 because the other option resulted in an even greater rate increase), the shippers in these instances could demonstrate that they engaged in actions that resulted in a true "meeting of the minds" between the parties. Consistent with centuries of contract jurisprudence, where there is clear factual evidence of this "meeting of the minds" that has been achieved through a meaningful negotiation between parties, the Board could properly find that the agreement at issue is a contract. But,

absent that meaningful power to negotiate, shippers must be able to avail themselves of the Board's authority over rates that Congress granted to balance the railroads' ability to issue tariffs (which, again, are essentially contracts of adhesion).

In short, it is not the parties' intent to enter into a "contract" that should be the basis of the STB's determination that an agreement is in fact a contract, but rather the shipper's ability to enter into a negotiated agreement at arm's length, *i.e.*, that the shipper has the ability (if it so chooses) to negotiate meaningfully the rate and other fundamental components of the contract (and not just the duration or volumes under service which it must take at a set rate and under predetermined conditions). Accordingly, the Board must make a case-by-case determination as to whether a shipper had the ability to negotiate or whether the shipper was subject to a non-negotiable common carrier rate.

Conclusion

EEI recommends that the Board conclude that rates established for coal transportation from the PRB, or for that matter from any other location or for any other commodity, be evaluated on a case-by-case basis to determine if they constitute a "contract" within the meaning of 49 U.S.C. § 10709. Congress clearly intended, by the use of the term "contract," to refer to agreements reached on an arms-length basis between two sophisticated entities, each with the ability to achieve some of its desired objectives in such an agreement.

Congress could not have intended, by the use of the word "contract," to refer to documents that essentially amount to a "take it or leave it" type of imposed set of rates and other terms of carriage, because the latter is, in function and in effect, little if any different than a tariff (or "published rate," to use the modern terminology). Indeed, if the

Board concluded that "take it or leave it" rates are "contracts," there would likely be few PRB rates that come within the jurisdiction of the Board, a result that Congress also could not have intended (because there would be little continuing need for an agency to regulate rail rates on coal, virtually the only commodity as to which rate complaints are still filed).

Respectfully submitted,



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SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 669

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CERTIFICATE OF SERVICE

I hereby certify that I have served this 4th day of June 2007, one copy of the foregoing "Comments on Proposed Rulemaking of Edison Electric Institute" by first-class mail, postage prepaid upon all parties on the official service list.


Michael F. McBride