

WASHINGTON LEGAL FOUNDATION

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Submitted electronically

Honorable Robert E. Primus
Chairman
Surface Transportation Board
395 E Street, S.W.
Washington, D.C. 20423-0001

Re: Growth in the Freight Rail Industry, Docket No. EP 775

Chairman Primus:

On behalf of Washington Legal Foundation, please consider this comment responding to the invitation for comments the Board published on July 15, 2024. WLF appreciates the opportunity to comment on growth in the freight-rail industry.

As a public-interest organization devoted to preserving America's free-enterprise system, WLF shares the Board's interest "in the health and growth of the industry and the need for rail customers to move their goods efficiently and reliably." The Board states that growth in the freight-rail industry has stalled over the past decade,¹ and the hearing offers the industry a chance to explain "how industry participants are strategizing and innovating to reverse this recent trend."

To effectively strategize and innovate, freight-rail businesses require a predictable set of rules uniformly enforced in a thoughtful, well-reasoned manner. WLF urges the Board to consider whether it provides such a regulatory environment. That inquiry should examine, among other Board actions, its enforcement of the common-carrier obligation under the Staggers Rail Act.

The Board's June 22, 2023 *Navajo Transitional Energy Company, LLC—Ex Parte Petition for Emergency Service Order* decision ("NTEC")² dramatically departed from precedent, injecting substantial uncertainty into freight-rail businesses' relationships with shippers. By a bare majority and based on an incomplete factual record at a preliminary injunction stage, the Board altered common-carrier policy in a manner inconsistent with the Staggers Act. In dissent, Board Member Fuchs criticized the majority's new common-carrier definition "based on the 'capacity' of a railroad" as "vague and potentially harmful," which could "lead to 'micromanaging of a carrier's operational decisions.'"³ In another dissent, Board Member Schultz predicted that a common-carrier approach predicated on a carrier's capacity representations in private negotiations could "drastically chill carriers' willingness to propose expected volumes in the context of contract negotiations."⁴

¹ Freight-rail interests have questioned the methodology the Board used to reach this conclusion. *See, e.g.*, Bill Stephens, *Railroads welcome opportunities to explain growth efforts to federal regulators*, TRAINS.COM, July 16, 2024, <https://perma.cc/KQ4Q-6ECH>.

² 2023 WL 4166666 (STB June 22, 2023).

³ *Id.* at *23 (Board Member Fuchs, dissenting).

⁴ *Id.* at *33 (Board Member Schultz, dissenting).

The *NTEC* ruling is at odds with at least two standards that the Board should have derived from the Staggers Act, argues attorney Bernard S. Sharfman in the attached Washington Legal Foundation *Legal Backgrounder*.⁵ “Ascertainable standards,” Mr. Sharfman writes, “are both policy objectives that the Board must use in its decision-making and the standards a reviewing court will use” when reviewing Board action under the Administrative Procedure Act (APA). The Staggers Act contains three ascertainable standards, two of which are relevant to analyzing the *NTEC* decision: 1) *Minimization of regulation*, derived from the 15 policy statements in the Act’s preamble, and 2) Procedures and standards that allow carriers to earn *adequate revenues*.

In *NTEC*, the Board failed to follow those ascertainable standards, Mr. Sharfman concludes. Deregulation was Congress’ primary goal for the Staggers Act. The law explicitly encourages private contracting. In dissent, Member Fuchs noted that the majority’s reliance on BNSF’s “willingness to contract” when determining its common-carrier obligation conflicts directly with the Act’s removal of “movements conducted pursuant to transportation contracts from the agency’s jurisdiction.”⁶ The Board’s must-carry order “provides NTEC more favorable terms under common carriage than NTEC was able to negotiate in its unexecuted contract with BNSF,” Member Schultz wrote in her dissent.

Mr. Sharfman also explains that *NTEC* undermines rail carriers’ ability to earn adequate revenues. The Staggers Act requires the Board to implement policies that “allow[] rail carriers to earn adequate revenues”⁷ and “attract and retain capital in amounts adequate to provide a sound transportation system.”⁸ When assessing the reasonableness of NTEC’s service request, the *NTEC* majority considered BNSF’s contract-negotiation assertion of capacity without analyzing the many external factors that impact a carrier’s ability to earn revenues, including other shippers’ demands and “preexisting contracts, potential degradation of overall service, and fluctuations in demand.”⁹ In the context of a private contract, if BNSF set aside 23 trains per month to carry NTEC’s freight, and NTEC does not utilize each of those trains, NTEC must pay BNSF liquidated damages to cover the lost opportunity cost. Under the Board’s common-carrier order, NTEC is under no obligation to use BNSF’s trains, and the rail carrier risks massive losses for which it cannot seek damages.

A decision that fails to abide by the Staggers Act’s ascertainable standards, Mr. Sharfman argues, exposes the Board to an APA challenge for arbitrary and capricious decision-making. Board Member Schultz underscored this point in her *NTEC* dissent, concluding that the decision “fails to ‘articulate a satisfactory explanation for its action including a ‘rational connection between the facts found and the choice made.’”¹⁰

⁵ Bernard S. Sharfman, *Common Carrier Regulation of Railroads Must Abide by Statute’s Ascertainable Standards*, WLF LEGAL BACKGROUNDER, Feb. 9, 2024, <https://perma.cc/XB67-YW3D>.

⁶ 2023 WL 4166666 at *30 (Board Member Schultz, dissenting).

⁷ 49 U.S.C. § 10101(3).

⁸ 49 U.S.C. § 10704(a)(1)(B).

⁹ 2023 WL 4166666 at *34 (Board Member Schultz, dissenting).

¹⁰ *Id.* at *35 (Board Member Schultz, dissenting), citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983).

BNSF filed a Petition for Review of the Board's *NTEC* decision with the Fifth Circuit on July 28, 2023.¹¹ The Fifth Circuit never had a chance to consider the Board's compliance with the APA, however, because BNSF and NTEC reached a settlement. NTEC filed an unopposed motion with the Board to dismiss its complaint with prejudice and vacate the June 22, 2023 decision. The Board unanimously voted to dismiss NTEC's claim but, on a 3-2 vote, denied NTEC's motion to vacate.¹²

In his dissent from the Board's refusal to vacate the decision, Board Member Fuchs focused on the June 22 decision's negative effects for both freight carriers and shippers, each of which would undermine growth in the industry. First, an increase in common-carrier obligations will deprive rail-freight businesses of the flexibility they need when responding to unseen developments such as decreases in supply. Second, the Board's decision undermines freight-carriers' resiliency against "the vagaries of the market, extreme weather events, and other factors that constantly change a rail carrier's capacity."¹³ Third, a government-mandated increase in the resources a rail carrier must use to fulfill the needs of one shipper "risks ineffectiveness or the imposition of excess costs" if the Board fails to factor in all potential future events that could arise from a must-carry order.¹⁴ Board Member Fuchs noted that the Board's *NTEC* decision did not undertake such an analysis.

A direct connection exists between freight-rail businesses' ability to pursue innovation and other growth strategies and how the Board implements the Staggers Act's common-carrier obligation. The *NTEC* decision elevates the risk of Board intervention into the shipping market and sets a vague new standard that complicates business decision-making. The Board's failure to follow the ascertainable standards Congress provided in the Staggers Act exposes Board decisions to APA-based legal challenge. Such litigation would foment further uncertainty.

In the upcoming hearings, Board Members should solicit testifying participants' opinions on the *NTEC* decision and its broader implications for growth. Board Members should also discuss how the Board can better consider impacts on growth and innovation when making future common-carrier determinations.

Respectfully submitted,

Glenn G. Lammi
Vice President of Legal Studies

Attachment

¹¹ *BNSF Railway Company v. Surface Transportation Board*, Petition for Review of a Decision of the Surface Transportation Board, Docket No. NOR 42178, Docket No. 23-60402 (5th Cir.; filed July 28, 2023).

¹² *Navajo Transitional Energy Company, LLC—Ex Parte Petition for Emergency Service Order*, 2023 WL 8650363 (STB Dec. 13, 2023)

¹³ *Id.* at *2.

¹⁴ *Id.*



Common Carrier Regulation of Railroads Must Abide by Statute's Ascertainable Standards

by Bernard S. Sharfman

The “common carrier obligation,” incorporated into federal law in 1887, requires freight rail carriers to haul freight on *reasonable* request at its common carrier (noncontractual) rate.¹ This obligation continues in force today under the Staggers Rail Act of 1980 (the “Act”).² Interestingly, the question of how the Surface Transportation Board (the “Board”)³ is to regulate this obligation has yet to be answered. This issue came to the fore in a recent Board decision ordering BNSF Railway (“BNSF”) to deliver a large amount of coal for Navajo Transitional Energy Company (“NTEC”) under BNSF’s common carrier obligation.⁴

In my recent white paper, *The Ascertainable Standards that Guide and Limit the Surface Transportation Board’s Authority over the Railroads*,⁵ I argue that the Board must take an ascertainable-standards approach in its decision-making, including its regulation of the common carrier obligation, to sustain its authority under the Act. Ascertainable standards are both policy objectives that the Board must use in its decision-making and the standards a reviewing court will use when determining if the Board has acted within its statutory authority under the Administrative Procedure Act (“APA”).⁶ Justice William Rehnquist adopted the analytical approach of identifying ascertainable standards in a regulatory statute such as the Act and then applying those standards in his *Industrial Union Dept., AFL-CIO v. American Petroleum Institute* concurring opinion.⁷ As discussed in my white paper, the ascertainable standards approach has as its foundation the nondelegation doctrine and its “intelligible principle” test.⁸

¹ *Issue Spotlight: Common Carrier Obligations for Rail Carriers*, INT’L CENTER FOR L. & ECON. (Mar. 16, 2023), <https://laweconcenter.org/spotlights/issue-spotlight-common-carrier-obligations-for-rail-carriers/>.

² Public Law No. 96-448 (10/14/1980). *See specifically*, 49 U.S.C. § 11101(a): “A rail carrier providing transportation or service subject to the jurisdiction of the Board under this part shall provide the transportation or service on *reasonable* request.”

³ The Surface Transportation Board is charged with regulating the freight rail industry. The Board was established in 1995 under the ICC Termination Act of 1995. *See* PUB. L. NO. 104-88 (1995).

⁴ Surface Transportation Board, Navajo Transitional Energy Company, LLC—Ex Parte Petition for Emergency Service Order, Decision, Docket No. NOR 42178 (June 23, 2023) at 1, https://dcms-external.s3.amazonaws.com/DCMS_External_PROD/1687536795653/51749.pdf.

⁵ *See* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4659375. The research associated with the white paper and this paper was funded by a grant from the Law & Economics Center, George Mason University’s Antonin Scalia Law School.

⁶ *See* 5 U.S.C. § 706.

⁷ *Industrial Union Dept., AFL-CIO v. American Petroleum Institute*, 448 US 607, 685-686 (1980).

⁸ *See* Sharfman, *supra* note 5.

The Act contains three ascertainable standards:

(#1) Minimization of Regulation: The fifteen policy statements found in the Act’s⁹ preamble direct the Board to minimize the regulation of railroads. This is the *primary objective* of the Act and the first ascertainable standard. One needs to think of these fifteen policy statements as forming an optimization problem where the objective, regulation, is being minimized. Importantly, the policy statements provide various constraints on the Board’s ability to achieve total deregulation of pricing and contracting, especially where “effective competition” may be lacking.

(#2) Reasonableness in Rate Setting: Carriers’ contractual or common carrier rates must be reasonable whether under conditions of effective competition or market dominance.¹⁰ Where effective competition exists, the Board allows carriers to set the rates. These rates carry the presumption of reasonableness and cannot be reviewed by the Board. Where market dominance exists and the Board has determined that a carrier is offering unreasonable rates, then the Board must determine what rates are reasonable. The Act defines market dominance as “an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies.”¹¹

(#3) Adequate Revenues: The Board must establish standards and procedures that provide rail carriers with adequate revenue levels so that they can earn “a reasonable and economic profit or return (or both) on capital employed in the business.”¹²

The Board should have followed ascertainable standards #1 and #3 in the BNSF matter.¹³ The Board’s refusal to apply these ascertainable standards increases the risk that a regulated entity could pursue a successful arbitrary-and-capricious challenge under Section 706(2)(A) of the APA. Ascertainable standard #2 is not applicable under the facts of this dispute.

The Facts¹⁴

NTEC exports coal to Japan and Korea. It is a captive shipper of BNSF and NTEC currently ships its coal under BNSF’s common carrier obligation. NTEC previously had contracts with BNSF for shipment of export coal, “but the primary contract expired at the end of 2022, while another contract—concerning service related to a single customer in Japan—expired in March 2023.”

From 2008 through 2019, NTEC’s predecessor had entered a long-term contract with BNSF. Following NTEC’s acquisition of its predecessor, NTEC assumed substantial liquidated damages owed to BNSF for failure to meet minimum tonnage requirements in both 2018 and 2019. NTEC also failed to meet its minimum tonnage requirements in 2020, incurring even more liquidated damages. The 2022 contract contained no minimum volume requirement, even though it contained a “maximum annual tonnage figure of 5.5 million tons.”

According to NTEC, “it requires delivery of approximately 438,625 tons of coal per month ... (roughly 29 trains per month) ..., and ratable train service within each month *consistent with a minimum of 29 trains per month.*” This was the level of service BNSF provided in 2021 and that was

⁹ 49 U.S.C. § 10101.

¹⁰ 49 U.S.C. § 10101(1).

¹¹ 49 U.S.C. § 10707(a).

¹² 49 U.S.C. § 10101(3) and § 10704(a)(2).

¹³ 49 U.S.C. § 10704(a)(2).

¹⁴ The facts presented are found in the Board’s decision. See Surface Transportation Board, *supra* note 4 at 2.

the level of service NTEC requested in its November 1, 2022, common carrier service request.

BNSF testified in 2022 that it was willing and tried to enter into a contract with NTEC to transport a *minimum* of 4.2 million tons of coal (amounting to about 23 trains per month) and a maximum of 6 million tons in 2023 (amounting to about 33 trains per month), and a *minimum* of 5.5 million tons and maximum of 6 million tons in 2024 (amounting to up to about 33 trains per month). However, the parties could not successfully negotiate based on those terms, resulting in NTEC's current use of BNSF's common carrier obligation.

BNSF testified that nothing has changed since December 2022 to make it believe that its capacity to transport coal as discussed in prior contract negotiations with NTEC had been diminished. Yet, according to NTEC, BNSF provided only 17 trains in February 2023 and 22 trains in March 2023. This was below the 24 and 30 trains that NTEC requested in November 2022. Further, NTEC claims that BNSF's increased provision of 27 trains in April and May 2023, respectively, and 22 trains in June 2023 was still inadequate.

NTEC also contends that BNSF has previously provided the number of trains and crews that it required. BNSF demonstrated that in 2021 and "its projections of moving 27 trains for NTEC in April and May 2023 indicate BNSF's ability to move higher levels of traffic on a consistent basis." To NTEC, this demonstrates "that its request for service is reasonable" and that BNSF is not meeting its common carrier obligation.

BNSF contests NTEC's claims. According to BNSF, current resource constraints created by demands from other shippers would mean the reallocation of "resources from other customers, including NTEC's competitors in the export coal market, putting the Board in the position of picking winners and losers in that market." Moreover, BNSF believes it has "acted reasonably in allocating constrained capacity in 2023." BNSF further contends that "under § 11101(a), a railroad does not violate its common carrier obligation if it satisfies its existing contractual obligations first." In addition, "BNSF claims that a carrier does not have to provide all the service a shipper requests; rather it must provide adequate service." Also, such adequate service is forward-looking, not based on historical experience, requiring capacity allocation decisions to be in the hands of the railroad, not the Board.

Based on these facts, the Board issued "a preliminary injunction ordering BNSF to transport a minimum of 4.2 million tons of coal on an annual basis in 2023 ... and an additional one million annual tons as capacity is available to serve NTEC."

In response to the Board decision, BNSF appealed to the U.S. Court of Appeals for the 5th Circuit.¹⁵ Subsequent to the appeal, the two parties filed a joint motion to hold the proceeding in abeyance with the intention to settle.¹⁶ Such a settlement will not prevent the Board from using its *BNSF* decision as authority when deciding subsequent cases.

Analysis

BNSF's common carrier obligation was the result of the two parties unsuccessfully negotiating terms and entering a contract. The parties' failure to agree on contractual terms is disappointing, as the Act strongly encourages private contracting. According to Section 10709(c)(1) of the Act, the

¹⁵ *BNSF Railway Company v. Surface Transportation Board*, Petition for Review of a Decision of the Surface Transportation Board, Docket No. NOR 42178, Docket No. 23-60402 (5th Cir.; filed July 28, 2023), https://dcms-external.s3.amazonaws.com/DCMS_External_PROD/1691159403753/51817.pdf.

¹⁶ Surface Transportation Board, Navajo Transitional Energy Company, LLC, Joint Motion to Hold Proceeding in Abeyance, Docket No. NOR 42179 (Nov. 9, 2023).

Board has no authority to review an executed contract between a shipper and a carrier. That lack of review authority is consistent with ascertainable standard #1—minimizing the regulation of the railroad industry subject.

It appears that the contractual stumbling block was NTEC's chronic inability to meet its minimum tonnage requirements. This repeated failure should have created a presumption in the minds of the Board commissioners that a reasonable service request should be significantly lower than the minimum tonnage amounts provided for in past contracts or minimum tonnage amounts must include a provision for liquidated damages. Instead, BSNF must set aside on average 23 trains per month for the shipping of NTEC coal even if NTEC does not utilize a single train during a specific month. Under contract, this lack of utilization would have required NTEC to pay liquidated damages to BNSF. But as Commissioner Michelle Schultz observed in her dissent from the Board's decision: "The Board now provides to NTEC more favorable terms under common carriage than NTEC was able to negotiate in its unexecuted contract with BNSF."¹⁷

The Board committed error in its analysis by only considering BNSF's capacity to provide service when it considered the reasonableness of NTEC's service request.¹⁸ Instead, it should have also considered how NTEC had consistently breached its past contractual obligations with BNSF. In sum, the opportunity costs that BSNF is forced to incur without compensation in the form of liquidated damages may result in the violation of ascertainable standard #3.

Moreover, this approach will undermine private contracting. According to Commissioner Schultz: "Allowing a shipper to obtain, through a common-carriage complaint, all the benefits of a contract without any of the reciprocal risk, will undermine the railroads' use of contracts, an essential and widespread tool that affords carriers the ability to better predict and plan for the overall demand on their systems."¹⁹ More specifically, Schulz notes that the majority's decision "bases its assessment of BNSF's common carrier obligation on private negotiations and draft contracts between the parties." For example, "the 4.2 million to 6 million annual tonnage projections [used by the Board], ... originate from the parties' private contract negotiations and confidential drafts." Schultz goes on to say that "this approach could drastically chill rail carriers' willingness to propose expected volumes in the context of contract negotiations, potentially dooming many future attempts at reaching private contracts."²⁰

Discouraging the use of private contracts means a corresponding increase in Board review of common carrier obligations. This result is in direct conflict with ascertainable standard #1. The Board must bear in mind that its approach in granting the preliminary injunction conflicts with ascertainable standards #1 and #3, which in turn exposes Board action to challenges under the APA for arbitrary and capricious decision-making.

¹⁷ *Id.* at 37.

¹⁸ *Id.* at 12.

¹⁹ *Id.* at 37.

²⁰ *Id.* at 36-37.