The Nuts and Bolts of Railroad Transportation Contracts

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Synopsis

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Before non-governmental transportation contracts were explicitly permitted by statute, it was thought by some people that they were illegal because they were, by definition, discriminatory. (In contrast, the Federal Government was always permitted by statute to have unique transportation arrangements when it acted as a shipper.) However, for unique movements, at least, such as long-haul coal transportation for one shipper, the discrimination argument is essentially theoretical. Contracts can be challenged as discriminatory, but no such case has ever been successfully argued.

In 1982, the United States Court of Appeals for the D.C. Circuit opined that the legality of such pre-1980 contracts was “less than crystal clear.”

1 49 U.S.C. § 10709(g)(2)B.
Reversing a district court opinion that pre-1980 transportation contracts were illegal, the Court of Appeals for the Tenth Circuit held that such a contract was not “per se illegal.” The current statute provides that contracts in effect on October 1, 1980 are lawful.


In Section 208 of the Staggers Rail Act of 1980, Congress for the first time explicitly authorized railroad transportation contracts. Congress also adopted a “grandfather” clause ratifying the legality of pre-Staggers Act contracts.

When railroads carry freight under contract, they are contract carriers, not common carriers. When they do not carry under contract, they are referred to as “common carriers.”

Former 49 U.S.C. § 10713 contained few restrictions on such contracts (except for agricultural contracts or those involving ports), beyond requiring their (eventual) filing with the Interstate Commerce Commission (ICC).

Such contracts may be kept confidential and nearly all such contracts — except for those involving agricultural products — are confidential, because railroads and many shippers demand that. Importantly, however, Section 10713 was crystal clear in providing that neither party to a contract had any liability to the other except as provided in the contract. Obviously, therefore, the terms of the contract became critical.

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4 See new 49 U.S.C. § 10709(e), and Section 208 of the Staggers Rail Act of 1980, Pub. L. No. 96-448.

5 Section 208 was codified at 49 U.S.C. § 10713 (since revised and renumbered as 49 U.S.C. § 10709).

6 Id., § 10713(j).

Arguably, such a limitation on liability (except as provided in the contract) precluded holdings such as those with respect to so-called “adhesion” contracts, that “public policy” considerations or “unequal bargaining power” allows a court to construe the contract in a manner that may not strictly conform to the terms of the contract.

By rule, the ICC also provided that service under a railroad transportation contract could begin before it was filed with the ICC, provided that it was required to eventually be filed. Presumably, though, it would have been a defense to enforcement of such a contract if it were never filed with the ICC. Now that such contracts are not filed with the Surface Transportation Board (STB), the availability of such a defense, even to an older contract, is also “less than crystal clear,” to quote then-Judge (now Justice) Ruth Bader Ginsburg.\footnote{Burlington, 679 F.2d at 936.} Eventually, there were so many railroad transportation contracts that the ICC provided by rule that only summaries of such contracts be filed (except for agricultural contracts).\footnote{In all the years of filing requirements, only one railroad transportation contract, to the best of the author’s knowledge, was ever subject to investigation by the ICC during the 60-day period after filing, as provided in (former) § 10713, and no relief resulted from the challenge.}

Enforcement of railroad transportation contracts, and any disputes arising from them are subject to state law, except where federal law otherwise provides, and may not be enforced by the ICC or the Surface Transportation Board, the ICC’s statutory successor.\footnote{49 U.S.C. § 10709(c)(2)(new).}
government. The railroads preferred that the federal government review abandonments, rather than the states, because states are generally opposed to abandonments, even if the line is not contributing to the overall profitability of the railroad. And railroads (except for Kansas City Southern and perhaps Conrail, in 1995) much preferred ICC review of mergers, under a pro-merger statute, to review by the Justice Department under the antitrust laws.

There was, therefore, general — but not universal — agreement in 1995 among most railroads and many shippers to maintain the core functions of the ICC in a new agency, the Surface Transportation Board, which is simultaneously “independent” and also part of the Department of Transportation.

The ICCTA thus preserved the statutory authority for railroad transportation contracts, while abolishing the Interstate Commerce Commission and creating the Surface Transportation Board. Even summaries of such contracts are no longer filed with the federal government, except for contracts for agricultural products. As a result of this special consideration in the statute for agricultural contracts, there are technical rules governing the summaries of such contracts which must be filed with the STB. Among the reasons that agricultural contracts are treated differently is that in most instances, agricultural shippers prefer uniform rates for all shippers so that when market prices justify the movement of grain from farm to market, some shippers are not able to move their grain because it would be uneconomical for them to do so, even though it would be profitable for their competitors to do so. Stated differently, without public availability of the essential terms of agricultural contracts, agricultural shippers cannot acquire sufficient information to attempt to ensure that their rates will be competitive with other shippers and, given the small margins in the grain industry, slight differences in rail rates can make the difference in determining the profitability (or lack thereof) of a movement.

13 49 C.F.R. Part 1313.
14 Thus, § 10709(d)(1) provides that “The Board shall publish special rules for such [agricultural] contracts in order to ensure that the essential terms of the contract are
In essence, the ICCTA provisions concerning transportation contracts are not substantially different (except for agricultural shippers) than were those in the Staggers Act. As in the Staggers Act, the only liability that either party may have to the other is under the contract.\(^{15}\) There are also putative limitations to prevent the commitment of most of the railroad car fleet to contract shipments, thereby creating a car shortage for non-contract shipments, but those provisions have never been triggered.\(^{16}\)

As stated, \textit{supra}, disputes arising under rail transportation contracts remain subject to state law, except insofar as federal law or the contract otherwise provides.\(^{17}\) Thus, for example, if “common carrier” obligations triggered a partial defense to a service obligation under a contract, federal law would determine those obligations, because it is federal law that confers common carrier status to railroads.\(^{18}\)

\section*{§ 7.04. Common Provisions of Railroad Transportation Contracts.}

Railroad transportation contracts must contain the standard terms that all written contracts must contain: mutual promises, consideration, and execution by competent representatives of each party. Because such contracts previously were required to be filed with the ICC/STB, it is probably necessary that railroad transportation contracts be written, not oral, which is why execution of a written document is probably necessary, unless it can be shown that a written document, such as a bill of lading, is evidence of an implied contract. The unique circumstances of railroad transportation typically call for a number of special provisions, or variations on typical provisions.

\(^{15}\) 49 U.S.C. § 10709(b).
\(^{16}\) 49 U.S.C. § 10709(h)(1).
\(^{17}\) \textit{See} 49 U.S.C. §§ 10709(c)(1)&(2).
\(^{18}\) \textit{See} 49 U.S.C. § 10501(b); see also definition of “rail carrier” in § 10102(5), the explicit acknowledgment of the common carrier obligation in § 10709(f) notwithstanding contractual obligations, and § 11101 (the common carrier obligation).
Some provisions are more appropriate for long-term contracts than short-term contracts. Examples include rate-adjustment provisions, service guarantees, and dispute resolution rules. Obviously, service problems and disputes can arise even with respect to short-term contracts, but the types of changed circumstances that often give rise to such problems are far more likely under a long-term contract, for several reasons. The most common reason is the unwillingness of shippers, who perceive themselves as dependent on the railroads, to litigate with railroads unless the problem is persistent. Generally speaking, contracts up to one year in term can be as short as one or two pages; contracts over one year in term often are 50 or 60 pages long. Length can be a virtue, not a vice, because over a period of 5 to 20 years, many possible disputes may arise. These days, electric utility contracts for transportation of coal by railroad are tending to be shorter, perhaps five to seven years or less, because of increasing concerns over the need to be competitive with other electric utilities. A well-drafted contract may serve to keep such disputes to a minimum.

First, the basic promises of each party:

**Railroad Promise.** The basic obligation of the railroad is to transport the commodity, at the rate(s) provided in the contract, and at some reasonable level of service. Stating this in the contract may seem elementary, but since the railroad may also be providing railcars, maintenance, or other such services, it helps to state the purpose(s) in the event of a dispute, such as if an injunction compelling service were sought. Moreover, it is especially important to stress some expectation as to quality or timeliness of service, because there is no reason for a shipper to enter into a contract unless it gets preferential service over non-contract shippers. Indeed, it is a fact that many shippers resort to trucks, despite their preference for the rail mode, because of the inability of railroads to offer consistent, high-quality service. For bulk shippers, timeliness may or may not be important. Because movement of bulk commodities is often captive to railroads, rates for such commodities tend to be higher than other commodities. Therefore, over a long period of time, it is unlikely that a railroad will fail to deliver the quantity of commodity covered by the contract, unless its system is terribly overwhelmed, or *force majeure* conditions prevail. But deliveries of all bulk commodities are often untimely, particularly when grain is moving to market in large quantities,
thus clogging the system, or when demand for transportation exceeds the railroad’s ability to serve. 19

**Shipper Promise.** The shipper commits to ship a particular commodity, or group of commodities, at the agreed-upon rate(s), during the term of the contract. Typically, the shipper commits to shipping a minimum quantity of the commodity. Lower rates and better service-commitments typically — but not always — go hand-in-hand with larger and larger quantities of commodities shipped and with shipper-owned railcars.

Additional provisions which are often found in railroad transportation contracts include the following:

**Opening Statements.** The parties to the contract should be clearly identified, so that disputes do not arise over whether parents or affiliates are bound by it. Typically, the state of incorporation should be named, as well as the origin(s) and destination(s), and importantly, the purpose of the contract (e.g., “the transportation of coal by railroad from the ABC mine in Gillette, Wyoming to the XYZ Generating Station in Hometown, USA”). Also, the contract should provide that it is a lawful agreement of the parties as of a particular date.

**Recitals.** The typical “whereas” clauses, which can help a neutral arbitrator or judge resolve a dispute. These are not binding, but can demonstrate intent.

**The “Consideration” Clause.** The drafter should include the standard “for $10 or other good and sufficient consideration” language typical of any contract governed by the state law in question.

**Term.** A definite term should be stated.

**Term Extensions.** Sometimes, the contract may be extended at the sole option of the shipper. The quid pro quo may be a rate renegotiation provision, to ensure that the carrier is not locked into a contract that may have become uneconomical. The provisions are increasingly infrequent, because of increasing competition in the electric utility industry.

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19 For example, the only railroads that serve the Powder River Basin in Wyoming — Burlington Northern and Santa Fe Railroad and Union Pacific Railroad — on occasion failed to comply with contractual commitments for significant quantities of coal because they over-committed to transport such coal while trying to wrest business from each other at the same time that they were upgrading the capacity of the “joint line” serving the Powder River Basin.
Rates. Railroad rates for bulk commodities are usually stated in dollars and cents per ton. Such rates may be tiered — that is, the rate per ton decreases as the volume commitment increases. In this way, the railroad benefits along with the shipper, because economies of scale are such that additional tons can usually be moved at much less than the minimum tonnage. In a large coal transportation contract, the minimum might be 50,000 tons per month, or 600,000 tons per year, or even more. Some contracts may not include rate provisions as such, but instead apply a stated percentage figure to published tariff rates. By statute, railroad “tariffs” technically do not exist any longer as documents filed with the federal government, but railroads still use their informal equivalent. Today, we refer to “published rates” when a railroad must provide “immediately” upon formal request by a shipper. By rule, the STB has decided that “immediate disclosure” means the next business day. Less common, but coming into vogue, are delivered-price contracts, combining the commodity price and the rail rate. Such provisions could force the railroad to share the available profit on the movement with the supplier, while simultaneously avoiding the complexity of negotiating two contracts that must mesh smoothly to avoid unanticipated inconsistencies. Recent trends include tying the railroad rate to the price of the electricity generated from the coal, and to paying for the rail transportation (or the coal, for that matter) until the coal is burned.

Free Return. The contract may explicitly provide for free return of empty cars.

Rate Adjustments. For long-term contracts, rate adjustments can be more important than the base rates. Typically, such provisions are tied to one of three indexes published by the STB, all of which are often referred to as “the” “Rail Cost Adjustment Factor” (RCAF). Technically, by law, there is only one RCAF for non-contract shipments. The adjustment in both the RCAF(A) and RCAF-5 is for longer-term railroad industry productivity.
Rate Renegotiation Provisions. There has been a great deal of litigation over rate adjustment issues, particularly the RCAF. Accordingly, even where the parties agree on a rate adjustment provision, they often provide for a rate renegotiation opportunity to discuss whether unforeseen events have caused the adjusted rate to depart from either party’s expectations or needs. Particularly in competitive industries, but also where regulatory scrutiny is significant, a rate “re-opener” is important to ensure that the rate still permits the shipper to be competitive.

Notification of Volumes to Be Shipped. Often, in major contracts with service obligations, the shipper must give pre-notification to the railroad of quantities intended to be shipped in the next month, quarter, or year. This allows the railroad to allocate its personnel and equipment efficiently. This provision is more likely to be included the higher the volume to be shipped and the greater the level of service demanded.

Service Commitments. These may be extremely important in manufacturing, where “just in time” processes have become commonplace. But railroads do not have a great track record in meeting such precise commitments. These commitments are essential for transportation in shipper-owned or -leased railcars, because otherwise the shipper’s investment is at risk with no control on the part of the shipper over its earning potential. For shipments in shipper-owned cars, elaborate provisions concerning transit time, car inspection and maintenance, and make-up for service failures or other shortcomings are necessary in order that the shipper be able to justify its investment in the railcars. 24

24 Many electric utilities now own fleets of railcars moving coal. American Electric Power, for example, owns about 4,000 cars. The investment in such cars is obviously substantial, and requires firm, precise service commitments. One of AEP’s subsidiaries, Indiana Michigan Power Company, sued Burlington Northern Railroad in late 1995 for breach of service commitments. The author represented Indiana Michigan Power Co. Burlington Northern denied that contract traffic was entitled to a statutory preference, and also contended that new contract traffic could create a delay that justified a failure to meet its service commitments to Indiana Michigan. Despite having drafted the liquidated-damage provision, Burlington Northern contended that it was unenforceable under Illinois law. The case was settled, on terms which are confidential. The defenses suggest the need for clarity on even seemingly obvious points.
Make-Up Provisions. Make-up provisions are more common than liquidated damages because the shipper typically prefers to move the commodity rather than receive the money. Electric utilities in particular must avoid jeopardizing their ability to generate the lowest-cost power. Penalty provisions are typically a last resort before contract termination.25

Equipment. The contract should be clear in whose equipment the transportation will occur, and at what rates. If transportation is in carrier-supplied equipment, the carrier should provide an affirmation of compliance with all legal requirements for such equipment. The same should be provided for shipper-owned equipment, but in addition the contract may specify who will perform maintenance of the shipper’s railcars (sometimes it is the carrier), where, how often, and at what price. The price is quite negotiable. Also, the contract should clearly provide the amount of compensation to be paid for damage to, or destruction of, the railcars in service, and whether the Association of American Railroads’ car values, or stipulated loss value (which are usually more favorable to shippers) are applicable.

Demurrage. Demurrage is a charge for shipper failure to release cars or equipment within a defined period of time. It is not appropriate if private cars are used, but is sometimes included anyway. A chart showing permissible times associated with loading or unloading times may avoid disputes particularly if delays are permitted for weather, time of day, or weekends and holidays.

Force Majeure. Force majeure provisions typically go hand-in-hand with service commitments and volume commitments. Each party wants to maximize its opportunity to invoke force majeure while minimizing the other party’s right to do so. Since there is usually only one such provision, the result is, typically, a compromise. Weather problems and equipment breakdowns are the most common areas of dispute, especially if inadequate railroad service has caused equipment problems or if substitute equipment is used which then performs differently. Economic problems alone are

25 Penalty provisions are illegal in some states unless they are really liquidated-damage provisions, designed to induce performance, in situations where actual damages are hard to determine. Where a liquidated-damage provision is determined to be a penalty, and thus unenforceable, alternative remedies that may be available are specific performance, actual damages, or termination of contractual obligations. Proving actual damages may be very difficult and certainly can be problematical.
generally not sufficient to invoke *force majeure* unless they are unexpected and very substantial, or even cataclysmic. That may be changing, however, in light of governmental regulatory actions. A series of recent cases hold that invocation of a *force majeure* defense for economic reasons creates a factual issue for a jury to decide.\(^{26}\)

It can be very difficult to get the client to pay attention to *force majeure* issues when drafting a contract, but it is important to do so because such disputes can involve lots of money and substantial economic harm.

**Receipt/Bills of Lading.** There should be a receipt for each shipment. The “Bill of Lading” has long been recognized as both a receipt and a contract in and of itself. Since it is conventional and well-understood, a Bill of Lading should probably be required.

**Indemnity/Insurance.** Either party may carry the insurance, but typically the carrier does so. So, too, it is conventional for the carrier to

\(^{26}\) See Langham-Hill Petroleum, Inc. v. Southern Fuels Co., 813 F.2d 1327, 1329-30 (4th Cir.), *cert. denied*, 108 S. Ct. 99 (1987); United States v. Brooks-Callaway Co., 318 U.S. 120, 123 (1943) (reversing Court of Claims decision excusing a party for occurrence of *force majeure* event that was within control of the party); Kaiser-Francis Oil Co. v. Producer’s Gas Co., 870 F.2d 563 (10th Cir. 1989) (payment still viable option when taking impracticable); Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co., 799 F.2d 265, 275 (7th Cir. 1986) (rejecting *force majeure* defense and holding company from complying with its contractual obligations); Int’l Minerals and Chem. Corp. v. Llano, Inc., 770 F.2d 879 (10th Cir. 1985) (*force majeure* provision of contract did not excuse buyer’s performance under take-or-pay contract following compliance with state environmental regulation because it was able to perform contract through alternative duty to pay, but buyer nevertheless excused from paying because ability to take gas was impracticable and thus buyer was “unable” to perform); Nissho-Iwai Co. v. Occidental Crude Sales, Inc., 729 F.2d 1530, 1540 (5th Cir. 1984) (determining application of California law on question of reasonable control); Golsen v. ONG Western., Inc., 756 P.2d 1209, 1212-14 (Okla. 1988) (failure of demand for natural gas under take-or-pay contract did not constitute *force majeure* event preventing pipeline from making payments under the terms of the contract); Northern Ill. Gas Co. v. Energy Coop. Inc. 461 N.E.2d 1049, 1057 (Ill. App. 1984) (public utility commission’s denial of requested rate did not constitute *force majeure* and did not excuse party from its obligation despite fact that party may suffer financial loss); Troxell v. Beacon Coal Co., 50 Pa. D. & C. 128, 131 (1943) (inability to market coal under take-or-pay contract does not constitute a *force majeure* event over which operator had no control); *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 517 F. Supp. 440 (E.D. Va. 1981).
indemnify the shipper for damage actions by third parties. Sometimes the shipper indemnifies the carrier for damage done to its equipment when on the shipper’s property or under the shipper’s control.

Safety. The parties should provide assurances to each other about compliance with all regulations. Particularly where hazardous materials are involved, the shipper should be required to warrant compliance with all DOT regulations, such as placarding the packaging.

Loss or Damage. Because the carrier has no liability except as provided in the contract, the contract must specify the carrier’s liability for loss or damage to the commodity and, if in shipper-supplied railcars, for the equipment. It is far better to be clear and provide for strict liability, to avoid disputes over negligence claims. Specific provisions about quality or type of replacement parts may be important to avoid disputes, as well as whether the shipper is to be compensated for equipment out of service.

Choice of Law. This provision is important, because it not only may determine the availability of remedies such as liquidated damages, but also may influence the ultimate venue.

Venue. Venue for litigation or arbitration can be important. Some courts are more sophisticated or better at resolving such disputes than others. Courts in locations where the shipper does business are likely to be concerned about contractual interpretations that do not ensure efficient service or the lowest rate. Conversely, courts in states where the railroad has substantial facilities may favor the railroad._specifying the location of litigation or arbitration may be important for the convenience of or the availability of the witnesses, who oftentimes are senior management of each company. Specifying venue also avoids litigation over that issue, and prevents a perhaps premature rush to the courthouse to gain litigation

advantage before a dispute has truly reached an impasse. Such battles can be costly, without ultimate benefit to the client.

**Dispute Resolution.** It is critical to specify whether litigation or arbitration is to be used to resolve disputes, whether parties agree to meet or provide notice a minimum number of days before suit can be filed or arbitration invoked, and the limitations period on a claim, if different than the applicable state law. If litigation is selected, the parties may want to waive jury trial. If arbitration is selected, the contract should specify how many arbitrators will be used, how they are to be selected, who pays them, who selects the neutral if parties cannot agree — oftentimes the Chief Judge of the United States District Court — what time limits (if any) may apply, and what arbitration rules apply. The contract should specify that commencement of litigation or arbitration does not preclude continuation of each party’s obligation to the other during the dispute-resolution period unless some minimum level of service has not been met.

**Severability.** The contract may provide that, if one or more provisions are found to be unlawful or unenforceable, the remaining provisions are still valid. Of course, it could also provide the contrary, but most bulk shippers and railroads prefer to keep the contract in place, even if one provision is unlawful.

**Notice and Service.** The contract typically provides the name, address, title, telephone number, and facsimile number of the person(s) to receive notice of any dispute, change in shipments, volumes, or schedules, or of a desire to renegotiate any matter. It may also provide that any contention that may be made about service of process is waived if notice is provided in the manner prescribed in the contract.

**Default.** The contract may provide that it may be terminated in the event of insolvency or bankruptcy of either party, or if the carrier fails to transport at least a certain percentage of the shipper’s annual volume commitment (if any). Less common are provisions allowing termination if the shipper has failed to make payment within a stated period of time.

**Competence of Representatives.** The contract may provide that the parties represent that the person executing the contract had the legal right to do so. This should eliminate any conceivable dispute about such matters.

**Proof of Filing.** If any law requires that the contract be filed with any governmental agency — such as a summary of an agricultural contract at
the STB — the contract should require the carrier, which is the only party typically allowed to file them, to send a copy to the shipper showing receipt by the agency. Otherwise, in the event of a dispute, the contract may be considered void ab initio.

**Assignment.** The contract should specify whether it is assignable by either party.

**Modification of Agreement.** The contract should specify that it is the entire agreement between the parties, and may not be modified except in writing.

**Confidentiality.** Typically, the contract is to be kept confidential, and not disclosed to third parties except as may be required by lawful authority. The contract may provide that either party must give prior notice to the other, at least 5 days before disclosure of the contract or any material provision thereof.

**Appendices.** Typically, rates, volume commitments, and examples of rate adjustments may be difficult to state clearly and precisely in words, and thus appendices attached to a contract showing computations, cumulative values, or hypothetical calculations of such things as rate adjustments are often enormously valuable in avoiding or resolving disputes. Such provisions are recommended, particularly to illustrate rate adjustments, and to show cumulative volume commitments if those are complex. If the rate(s) applicable are complex, such as those that are tiered depending on volume, it may be useful to illustrate the effect of such things as *force majeure* on the applicable rate(s).

§ 7.05. **Problems that Arise.**

**Rate Adjustment Provisions.** There was a great deal of litigation over the issue of “productivity” adjustments to the “Rail Cost Adjustment Factor” published by the ICC and now the STB.\(^{27}\) After the ICC adopted a “productivity adjustment” to the RCAF, litigation or arbitration erupted over “which” RCAF — the RCAF (Unadjusted) or RCAF (Adjusted) —

the parties intended. Be clear on the index or methodology used, and illustrate it in an Appendix for additional clarity.

**Applicable Rate in the Event of Force Majeure.** Typically, large-volume bulk-commodity contracts provide for rate reductions over certain volume levels. It should be clear whether a force majeure event does, or does not, reduce the volume level(s) at which rate reduction(s) occur. Again, illustrate what is intended in an Appendix.

**Service Commitments.** With greater and greater volumes of coal moving longer distances because of Clean Air Act obligations and the increased frequency of use of shipper provided railcars, breaches of service commitments are occurring. Imprecision in calculating such commitments leads to disputes.

**Accidents.** Increased use of shipper-provided railcars makes it imperative to specify indemnity, insurance, and maintenance obligations. Suits against the shipper and railcar manufacturer, in addition to the carrier, are becoming more common, as a result of accidents.

§ 7.06. **Conclusion — New Approaches to Railroad Contracts: Long-Term Relationships with Short-Term Rates.**

Because of the rapidly evolving restructuring of the electric utility industry, utility coal shippers have felt the need to have greater flexibility in their rates in order to be competitive. At the same time, many shippers desire a long-term relationship with a railroad for many reasons. The compromise increasingly is a long-term contract with frequent revisions to the applicable rate.

A variation on the long-term contract with frequent rate revisions is a short compact between railroad and shipper, agreeing in principle to a largely exclusive relationship, with general understandings of the terms governing the relationship, and an agreement to negotiate specific terms in good faith as warranted. Such compacts are now coming into vogue.