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Dear Reader:

The Transportation Law Journal at the University of Denver, Sturm College of Law is honored to present Volume 50 no. 2, the spring publication by our 2025-2026 editorial staff. This volume features the article “The Significance of ‘Adequate Revenues’ Under the Staggers Rail Act of 1980” by author Bernard Sharfman. We hope that you will find it as thought-provoking as we have.

Thank you to our dedicated staff for their work on this journal. This publication would not be possible without every single one of you and your dedication to forwarding the mission of the Transportation Law Journal.

Sincerely,

Ellie Bowen

Editor-in-Chief

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Article

The Significance of ‘Adequate Revenues’ Under the Staggers Rail Act of 1980

Bernard S. Sharfman*

ABSTRACT

The Staggers Rail Act of 1980 requires the Surface Transportation Board (“STB”) to be proactive in making sure freight railroads (“carriers”) earn adequate revenues. Forty-five years later there is still debate on whether carriers are earning adequate revenues, how adequate revenues are to be defined and calculated, whether the Act allows the STB to put an upper bound on a carrier’s revenues when they are determined to be earning adequate revenues, and how revenue adequacy impacts rate setting in market dominant situations.

In exploring these issues, this Article provides the following conclusions and recommendations. First, the STB’s annual revenue adequacy determinations are not compliant with what the Staggers Act requires. Therefore, these

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determinations must be considered worthless for any type of regulatory use. Second, any type of upper bound imposed by the STB on the revenues earned by a carrier is beyond its statutory authority. Third, the use of adequate revenues as a limitation or cap on the STB's determination of a reasonable maximum rate in market dominant situations is also beyond its statutory authority. This leads to the recommendation that the revenue adequacy constraint found in the Coal Rate Guidelines be rescinded. It also leads to the recommendation that the STB's three-benchmark test be revised so that rate setting under this method is no longer a function of earning adequate revenues.

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I. INTRODUCTION

The legal significance of freight railroads ("carriers") earning "adequate revenues" is the focus of this writing. Section 10704(a)(2) of the Staggers Rail Act of 1980 (the "Act")¹ requires the SURFACE Transportation

1. Staggers Rail Act of 1980, 49 U.S.C. §§ 10101-11908.

Board ("STB"),² the regulator of the freight rail industry, to be proactive in making sure carriers earn adequate revenues:

The Board shall maintain and revise as necessary standards and procedures for establishing *revenue levels* for rail carriers providing transportation subject to its jurisdiction under this part that are *adequate* . . . The Board shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph.³

The need for "adequate revenues" was also codified as one of the fifteen policy objectives listed in The Rail Transportation Policy section of the Act:⁴ "In *regulating* the railroad industry, it is the policy of the United States Government . . . to promote a safe and efficient rail transportation

2. See ICC Termination Act of 1995, Pub. L. No. 104-88, § 10501(a)(2) 109 Stat. 803 (1995) (the Surface Transportation Board is a five-member independent agency of the federal government. It is the successor to the Interstate Commerce Commission and is primarily charged with regulating the rail industry under the Staggers Rail Act of 1980. The Board was established in 1995 under the ICC Termination Act of 1995).

3. 49 U.S.C. § 10704(a)(2).

4. In regulating the railroad industry, it is the policy of the United States Government—

- (1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;
- (2) to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required;
- (3) to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Board;
- (4) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense;
- (5) to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes;
- (6) to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;
- (7) to reduce regulatory barriers to entry into and exit from the industry;
- (8) to operate transportation facilities and equipment without detriment to the public health and safety;
- (9) to encourage honest and efficient management of railroads;
- (10) to require rail carriers, to the maximum extent practicable, to rely on individual rate increases, and to limit the use of increases of general applicability;
- (11) to encourage fair wages and safe and suitable working conditions in the railroad industry;
- (12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination;
- (13) to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on rail carriers of developing and maintaining the capability of providing such information;
- (14) to encourage and promote energy conservation; and

system by allowing rail carriers to earn *adequate revenues*, as determined by the Board . . .⁵

This statutory focus on carriers earning adequate revenues is not surprising given that carriers were far from earning such revenues when the Act became law in 1980.⁶ As explained by President Jimmy Carter when signing the Act:

In recent decades the problems of the railroad industry have become severe. Its 1979 rate of return on net investment was 2.7 percent, as compared to over ten percent for comparable industries. We have seen a number of major railroad bankruptcies and the continuing expenditure of billions of Federal dollars to keep railroads running. Service and equipment have deteriorated. A key reason for this state of affairs has been overregulation by the Federal Government. At the heart of this legislation is freeing the railroad industry and its customers from such excessive control.⁷

President Carter's comments are consistent with other findings found in the original language of the Act:

The Congress hereby finds that . . .

(6) earnings by the railroad industry are the lowest of any transportation mode and are insufficient to generate funds for necessary capital improvements;

(7) by 1985, there will be a capital shortfall within the railroad industry of between \$16,000,000,000 and \$20,000,000,000;

(8) failure to achieve increased earnings within the railroad industry will result in either further deterioration of the rail system or the necessity for additional Federal subsidy; and

(9) *modernization of economic regulation for the railroad industry with a greater reliance on the marketplace* is essential in order to achieve maximum utilization of railroads to save energy and combat inflation.⁸

(15) to provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part. 49 U.S.C. § 10101.

5. *Id.*

6. See Jimmy Carter, *Staggers Rail Act of 1980 Statement on Signing S. 1946 Into Law*, THE AMERICAN PRESIDENCY PROJECT (Oct. 14, 1980), <https://www.presidency.ucsb.edu/documents/staggers-rail-act-1980-statement-signing-s-1946-into-law>.

7. *Id.*

8. 49 U.S.C. § 10101 (emphasis added).

This was the state of the industry despite a major piece of railroad legislation that went into effect in 1976, the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4R Act").⁹ While implemented with the expectation of revitalizing the railroads,¹⁰ the ineffectiveness of the 4R Act was quickly recognized, requiring a redo.¹¹ Hence, the necessity for the Act.

In summarizing the state of freight rail regulation during that time, esteemed economics professors Robert D. Willig and William J. Baumol stated the following: "Rail regulation undermined competition through protectionist rules, froze rail business into inefficient and outdated patterns, interfered with and delayed private decisions, and, ironically, virtually precluded the financial viability of railroads."¹²

In sum, the Act was an acknowledgment that the past regulatory approach had failed.¹³ To resolve this regulatory failure, the Act takes the approach of allowing carriers to earn much higher levels of revenues in order to create and maintain a sound freight rail transportation system.¹⁴

Forty-five years later the Act is still drawing acclaim for its success in turning around the freight rail industry.¹⁵ However, there is still debate on whether carriers are earning adequate revenues, how adequate revenues are to be defined and calculated, whether the Act allows the STB to put an upper bound on a carrier's revenues when they are determined to be adequate, and how revenue adequacy impacts rate setting in market dominant situations.¹⁶ These are the issues that are addressed in this writing.

Part II of this Article will discuss the statutory language on adequate revenues. "Adequate revenues" is a term requiring a complex mix of statutory definition and a required regulatory approach that treats the required financial targets as minimums, not maximums, and views adequate revenues not as an end in itself but as the means to accomplish system-wide objectives. This complexity is something that has been seriously overlooked

9. Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210, 90 Stat. 31 (1976).

10. Gerald R. Ford, *Statement on the Railroad Revitalization and Regulatory Reform Act of 1976*, THE AMERICAN PRESIDENCY PROJECT (Feb. 5, 1976), <https://www.presidency.ucsb.edu/documents/statement-the-railroad-revitalization-and-regulatory-reform-act-1976>.

11. CSX Transp. v. United States, 867 F.2d 1439, 1443 (D.C. Cir. 1989); see Jeffrey T. Macher, John W. Mayo & Lee F. Pinkowitz, *Revenue Adequacy: The Good, the Bad and the Ugly*, 41 TRANSP. L.J. 85, 94 at n.39 (2014) ("while nominally granting pricing flexibility, these rate-making freedoms [found in the 4R Act] were 'largely emasculated' by the ICC, effectively retaining many regulatory constraints of the pre-4R Act.") (citing THEODORE E. KEELER, RAILROADS, FREIGHT AND PUBLIC POLICY: STUDIES IN THE REGULATION OF ECONOMIC ACTIVITY 97 (1983)).

12. Robert D. Willig & William J. Baumol, *Using Competition as a Guide*, 11 REGUL. 28, 30 (1987).

13. U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-166, FREIGHT RAIL PRICING CONTRACTS PROVIDE SHIPPERS AND RAILROADS FLEXIBILITY, BUT HIGH RATES CONCERN SOME SHIPPERS (2016).

14. *Id.*

15. Jerry Ellig, *Forty Years After Surface Freight Deregulation*, THE REG. REV. (Dec. 14, 2020), <https://www.theregreview.org/2020/12/14/ellig-forty-years-after-surface-freight-deregulation/>.

16. 49 U.S.C. § 10707(a).

by both the STB and its predecessor, the Interstate Commerce Commission ("ICC").

Part III will discuss the calculation of revenue adequacy for freight rail carriers ("carriers")—both the statutory requirements and what is done in practice by the STB. It is argued that the STB revenue adequacy determinations are nowhere close to what the Act requires. Therefore, these determinations must be considered worthless for any type of regulatory use and, if challenged in court, would most probably be found to be an arbitrary and capricious act¹⁷ under Section 706(2)(A) of the Administrative Procedure Act ("APA").¹⁸

To properly solve for the required financial targets and estimate what adequate revenues the carriers will need to accomplish system-wide objectives, a high-level team of experts in industry operations, rail transportation, economics, and finance is necessary. The establishment of such a team is the only way the STB can become compliant with the Act. This, in turn, requires the STB to budget for the establishment of this team and its ongoing work.

Part IV will discuss what the Act says about setting a cap on how much revenue a carrier can earn. It will be argued that the statute puts no limit on how much those earnings may exceed adequate revenues. Any type of upper bound imposed by the STB on the revenues earned by a carrier would be beyond its statutory authority and therefore in violation of Section 706(2)(C) of the APA.¹⁹

Part V will discuss the relationship between adequate revenues and the setting of reasonable maximum allowable rates in market dominant situations. It will be argued that the determination that a carrier is earning adequate revenues cannot be used as a factor in limiting or capping the STB's maximum allowable rate determinations. Including such a factor is beyond the STB's statutory authority and therefore in violation of Section 706(2)(C) of the APA.²⁰ This leads to the recommendation that the revenue adequacy constraint ("RAC") found in the Coal Rate Guidelines ("Guidelines") be eliminated as one of the four constraints used in

17. *FCC v. Prometheus Radio Project*, 592 U.S. 414, 423 ("The APA's arbitrary-and-capricious standard requires that agency action be reasonable and reasonably explained. Judicial review under that standard is deferential, and a court may not substitute its own policy judgment for that of the agency. A court simply ensures that the agency has acted within a zone of reasonableness and, in particular, has reasonably considered the relevant issues and reasonably explained the decision.").

18. 5 U.S.C. § 706(2)(A) ("The reviewing court shall . . . hold unlawful and *set aside* agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . .") (emphasis added).

19. 5 U.S.C. § 706(2)(C) ("The reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right . . .") (emphasis added). *See also* *Citizens Committee for Hudson Valley v. Volpe*, 425 F.2d 97, 101 (2nd Cir. 1970) ("Section 706(2) (C) permits the reviewing court to set aside agency action found to exceed the agency's statutory authority.").

20. *See* 49 U.S.C. § 10707(b).

the STB’s determination of reasonable allowable rates in market dominant situations.²¹ This can be done by the STB rescinding the RAC found in the Guidelines. Such a rescission would be consistent with President Trump’s recent executive order that seeks the repeal of regulations “that clearly exceeds the agency’s statutory authority or is otherwise unlawful.”²²

The lack of statutory authority found in Part V also supports the recommendation that the STB revise one of its simplified methods of rate determination—the three-benchmark test. This approach currently permits STB rate determinations to be limited or capped based on whether a carrier is earning adequate revenues. The three-benchmark test must be revised such that it longer includes this type of rate cap.

Part VI provides a summary of the recommendations found in this Article.

II. THE STATUTORY LANGUAGE ON ADEQUATE REVENUES

Section 10704(a)(2) of the Act provides the operative language on adequate revenues.²³ The statutory language presents a complex picture of adequate revenues that are meant to allow individual carriers to achieve multiple strategic financial objectives and, in turn, allow the freight rail transportation system to achieve system-wide objectives.

A. OPERATIVE LANGUAGE

The operative language found in Section 10704(a)(2) of the Act requires that the STB be proactive in making sure carriers earn what is referred to as “adequate revenues:”

The Board shall maintain and revise as necessary standards and procedures for establishing revenue levels for rail carriers providing transportation subject to its jurisdiction under this part that are adequate, under honest, economical, and efficient management, for the infrastructure and investment needed to meet the present and future demand for rail services and to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business. *The Board shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph.* Revenue levels established under this paragraph should—

(A) provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable

21. *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985).

22. Presidential Memorandum Directing the Repeal of Unlawful Regulations, 2025 DAILY COMP. PRES. DOC. 202500466 (April 9, 2025).

23. 49 U.S.C. § 10704(a)(2).

level of debt, permit the raising of needed equity capital, and cover the effects of inflation; and

(B) attract and retain capital in amounts adequate to provide a sound transportation system in the United States.²⁴

Adequate revenues allow carriers “to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business”... and provide “a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation.”²⁵

The language of Section 10704(a)(2) requires the Board to “assist” carriers in achieving adequate revenues in order to achieve the statutorily stated financial targets: “The Board shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph.”²⁶ This language must be understood in its historical context. The industry’s severe financial distress meant that carriers were far and away from earning adequate revenues at the time the Act became law.²⁷ Meeting the specific and comprehensive financial targets identified in the Act would allow carriers to become financially sound and avoid the risk of insolvency.²⁸ This is the original meaning of the language found in this section of the Act.

For the STB to make an adequate and continuing effort “to assist carriers in attaining revenue levels” to meet the stated financial targets, the STB must allow carriers to exceed those targets. The risk of failing to meet these financial objectives becomes exponentially multiplied when the STB treats them as maximums to be targeted, not minimums. Falling short is a failed outcome under the statutory language. Therefore, these financial objectives must be understood as minimums, not maximums. In sum, the statutory language and the historical financial context require us to understand the term “adequate revenues” as establishing “a lower bound below which firms would eventually face insolvency.”²⁹

It is also clear that the targeting of adequate revenues in order to achieve various financial targets is not an end in itself. These revenues are necessary to achieve two closely related “system-wide objectives”: 1) creating “the infrastructure and investment needed to meet the present

24. *Id.* (emphasis added).

25. *Id.*; see Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, § 205, 90 Stat. 41 (1976) (original use of “adequate revenues.”).

26. 49 U.S.C. § 10704(a)(2).

27. 49 U.S.C. § 10101 (findings).

28. Gerard J. McCullough, *Constrained Market Pricing and Revenue Adequacy: Regulatory Implications for Shippers and Class I U.S. Freight Railroads* 1, 28 (UNIV. OF MINN., DEP’T OF APPLIED ECON., Working Paper No. P15-5, 2015) <http://ageconsearch.umn.edu/handle/207766>.

29. *Id.* (emphasis added).

and future demand for rail services” and 2) “attract[ing] and retain[ing] capital in amounts adequate to provide a sound freight rail transportation system.”³⁰ Placing a cap on the ability of carriers to earn revenues hampers their ability to meet these statutory objectives. Therefore, the STB should be encouraging carriers to earn greater than adequate revenues in order to enhance the potential for achieving system-wide objectives.

Moreover, what is meant by the proper level of adequate revenues for each carrier under the statute frequently changes over time. The world in which carriers exist is constantly changing. Economic conditions may be characterized by slow or high demand for their services. Interest rates and equity rates of return to finance capital investment may vary significantly.

This non-static environment may mean that, at certain times, the STB must be willing to encourage carriers to use their market power in order to earn the required adequate revenues. This may be especially useful in times of severe financial distress or where capital demands of the industry are immense. In regard to the former, a carrier’s leveraging of its market power may be necessary in times such as the Great Recession or the COVID-19 pandemic.³¹ In regard to the latter, high levels of adequate revenues may be required to make the investments necessary to meet the high levels of demand for their services. On the other hand, “adequate” (defined as “sufficient for a specific need or requirement”³²) must also be interpreted to mean that the STB must help establish a revenue floor in order “to cover total operating expenses . . . provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt,” etc.

In sum, what the Act means by adequate revenues is complex. It involves both the statutory definition and a regulatory approach that treats financial targets as minimum thresholds, not maximums. Adequate revenues must not be viewed simply as a means to create financial soundness, but also as a means to accomplish system-wide objectives.

III. CALCULATING REVENUE ADEQUACY

Section 10704(a)(3) directs the STB to annually calculate which rail carriers are earning adequate revenues:

30. 49 U.S.C. § 10704(a)(2).

31. Max T.M. Ng, Joseph Schofer & Hani S. Mahmassani, *How Well Did U.S. Rail and Intermodal Freight Respond to the COVID-19 Pandemic versus the Great Recession?*, 2677(4) *TRANS. RES. REC.* 597, 597 (2023), <https://pmc.ncbi.nlm.nih.gov/articles/PMC10034561/>.

32. *Adequate*, *MERRIAM-WEBSTER DICTIONARY*, <https://www.merriam-webster.com/dictionary/adequate> (last visited Apr. 6, 2025).

“On the basis of the standards and procedures described in paragraph (2), the Board shall annually determine which rail carriers are earning adequate revenues.”³³

Interestingly, the STB does not make this annual calculation for all carriers.³⁴ Under the statutory authority found in Section 11145(a),³⁵ the STB only requires Class I railroads, the six largest carriers,³⁶ to provide what it deems the necessary information to do the revenue adequacy calculations.³⁷

The Act’s complex definition of adequate revenues has a major impact on the STB’s calculation of revenue adequacy. In determining the correct level of adequate revenues, it is critical for the STB to keep in mind the “standards and procedures” in paragraph (2) of Section 10704(a). The determination must focus on all financial targets, and connect those to the system-wide objectives. This solving of simultaneous equations is a complex process. Not only must the STB determine the right amount of adequate revenues to meet all financial targets identified in paragraph (2) (level of capital investment, rates of return and profitability, debt coverage, etc.), it must also find the correct level of adequate revenues to achieve the two system-wide objectives. Any regulatory determination of adequate revenues that does not take this approach, in whatever simplified form, is not following the requirements of the Act.

The solving of these equations also requires a forward looking approach. To calculate revenue adequacy the STB must look to the future over a multi-year period. The need for such an approach is discussed by Professors Murphy and Zimjewski in the context of economic return and profit:

The relevant economic rate of return for purposes of understanding whether railroads are sufficiently revenue adequate to provide efficient and competitive service to shippers is a *forward-looking* measure of a company’s ability to cover future operating expenses, assure

33. 49 U.S.C. § 10704(a)(3).

34. See ASS’N OF AM. R.R.S, RESOURCES, (last updated March 2025) <https://www.aar.org/resources/>.

35. 49 U.S.C. § 11145(a) (“The Board may require—(1) rail carriers, lessors, and associations, or classes of them as the Board may prescribe, to file annual, periodic, and special reports with the Board containing answers to questions asked by it; and (2) a person furnishing cars to a rail carrier to file reports with the Board containing answers to questions about those cars.”).

36. ASS’N OF AM. R.R.S, *supra* note 34 (The freight rail network is nearly 140,000 miles. There are six Class I railroads (railroads with revenue of at least \$1.07 billion [updated]) and approximately 615 short line railroads (Class II and III). Class I railroads account for around 67% of freight rail mileage, 87% of employees and 94% of revenue. Freight rail accounts for around 40% of long-distance ton-miles — more than any other mode of transportation”); *Economic Data*, SURFACE TRANSP. BD. (last visited Feb. 7, 2026), <https://www.stb.gov/reports-data/economic-data/> (providing updated statistic for classification of Class I railroads).

37. 49 C.F.R. § 1241.11 (2016).

repayment of its debt, and attract and retain the necessary capital to maintain, upgrade and replace its assets. Economic profitability is calculated as the rate at which expected *future* cash flows from making an investment today must be discounted to equal the initial investment. Investors will be willing to lend to a company if the expected future returns on investment will be as high as the investor can expect (after accounting for risk) from alternative investment opportunities.³⁸

A. CRITIQUE OF CURRENT REVENUE ADEQUACY DETERMINATIONS

Despite the statutory command that annual revenue adequacy determinations comply with the standards and procedures found in paragraph (2), the STB does not take a simultaneous equation approach to assess whether carriers are earning adequate revenues.³⁹ Most importantly, the system-wide objectives are not taken into consideration.⁴⁰ Neither are the entire range of financial targets explicitly addressed in Section 10704(a)(2).⁴¹ The STB bases its adequacy determinations only on one very simplistic calculation: whether a Class I railroad achieves a return on investment [“ROI”] equal to at least the current cost of capital [“COC”] for the railroad industry.⁴² This calculation, which has been in use prior to the Act,⁴³ is summarized in the STB’s 2023 revenue adequacy determination:

In Railroad Cost of Capital—2023, EP 558 (Sub-No. 27) (STB served Aug. 07, 2024), the Board determined that the 2023 railroad industry cost of capital was 9.87%. By comparing this figure to the 2023 ROIs,

38. J. Petition for Rulemaking to Modernize Ann. Revenue Adequacy Determinations before the S.T.B., *Ex Parte* 766, Verified statement by Kevin M. Murphy and Mark E. Zimjewski at 15 (Sept. 1, 2020).

39. See 49 U.S.C. § 10704(a)(2); see also J. Petition, *supra* note 38, at 8–9.

40. See J. Petition, *supra* note 38, at 8–9.

41. See 49 U.S.C. § 10704(a)(2).

42. According to the Coal Rate Guidelines:

We have previously determined, in *Ex Parte* No. 393, *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981), affirmed, *Bessemer & Lake Erie R. Co. v. United States*, 691 F. 2d 1104 (3d Cir. 1982), cert. denied, 103 S. Ct. 2473 (1982), that “adequate” revenues are those which provide a rate of return on net investment equal to the current cost of capital (i.e., the level of return available on alternative investments). This is the revenue level necessary for a railroad to compete equally with other firms for available financing in order to maintain, replace, modernize, and, where appropriate, expand its facilities and services. If railroads cannot earn the fair market rate of return, their ability both to retain existing investments and obtain new capital will be impaired, because both the existing and prospective funds could be invested elsewhere at a more attractive rate of return.

Coal Rate Guidelines, *supra* note 21, at 36–37.

43. Macher et. al., *supra* note 11, at 97 (quoting Adequacy of Railroad Revenue (1978 Determination); 362 I.C.C. 199 (1979)).

calculated from data reported in the carriers' Annual Report R-1 Schedule 250 filings, a revenue adequacy figure has been determined for each of the Class I freight railroads that were in operation as of December 31, 2023.⁴⁴

Incorporated into the STB's non-statutory approach is a heavy reliance on backward-looking data, "the return on the historical net investment base."⁴⁵ Doing so means that the STB does not have an understanding of revenue adequacy in forward-looking terms. The data is not representative of current asset valuations which incorporate expectations of future cash flows. For example, as noted by Professor Joseph Kalt:

[T]he depreciated book value of the assets based on historical investment costs likely grossly understates the current competitive market value or replacement cost of these assets. Historical book accounting does not adjust for the effect of inflation on the value of long-lived capital goods. And railroad assets are especially long-lived. The price of rail equipment, parts, and construction twenty, thirty (or more) years ago can be a fraction of the current competitive market value . . .⁴⁶

Professor Kalt further notes that the exclusion of deferred taxes from a railroad's asset base in the current revenue adequacy calculation overstates the revenue adequacy of the railroad.⁴⁷

As the Eleventh Circuit has explained:

"Accounting profits differ from economic profits in several important ways . . . [A]ccounting profits exceed economic profits. Thus, the perfectly competitive firm in equilibrium earns zero [or normal] economic profits though its normal returns are reflected in positive accounting profits. Hence, substantial accounting profits—say, 20 percent—may be consistent with trivial or zero [normal] economic profit . . ."⁴⁸

Consistent with this dicta, Professors Murphy and Zimjewski, using the same methodology as the Board to calculate railroad revenue adequacy, found that 89% of the S&P 500 earn ROIs over their COC.⁴⁹

44. *R.R. Revenue Adequacy Chart 2024*, SURFACE TRANSP. BD., <https://www.stb.gov/wp-content/uploads/Revenue-Adequacy-Chart-2024.pdf>.

45. J. Petition, *supra* note 38, at 14 ("Accounting measures based on backward looking historical purchase prices and depreciation of the railroad's assets often are uninformative about a firm's ability to attract capital in the future.")

46. Assoc. for Am. R.R., Comments before the Surface Transp. Bd., *Railroad Revenue Adequacy*, STB Ex Parte No. 722, attach. Testimony of Joseph P. Kalt ¶ 67 (Nov. 26, 2019).

47. *Id.*

48. *Bailey v. Allgas, Inc.*, 284 F.3d 1237, 1252 n.21 (11th Cir. 2002).

49. J. Petition, *supra* note 38, at 49.

Therefore, even if ROI and COC could be used to sufficiently determine revenue adequacy on an annual basis, the STB's current backward-looking approach dooms its effectiveness.⁵⁰ According to the Guidelines: "[R]evenue adequacy is a long-term [forward-looking] concept that calls for a company, over time, to average return on investment equal to its cost of capital. In any industry there are business cycles producing years during which earnings exceed projections and years when they fall short of the target."⁵¹ As should be apparent, this long-term concept is not incorporated into the STB's calculations.⁵²

In sum, the STB's annual revenue adequacy determinations based on ROI/ROC is nowhere close to what the Act requires. Stripping away the complexity of what needs to be calculated makes sense only if the simplification leads to approximating what the statute requires. Here, it does not. As previously discussed, not all of the financial targets are included and the system-wide objectives are not taken into consideration. Therefore, this formula, despite the 3rd Circuit Opinion's blessing in *Bessemer v. ICC*,⁵³ must not be considered a "permissible alternative"⁵⁴ for any type of regulatory use and, if challenged in front of a panel of judges in the federal courts of appeal outside the 3rd Circuit or en banc in the 3rd Circuit,⁵⁵ would most likely be found to be an arbitrary and capricious act under 706(2)(A) of the APA.

B. RECOMMENDATION

The STB has a statutory obligation to do its annual revenue adequacy determinations in a way that is compliant with Section 11704(a)(2) of the Act.⁵⁶ Not doing so would be a violation of the APA.⁵⁷ As required by Section 11704(a)(3), the annual determinations must be done "[o]n the basis of the *standards and procedures* described in" Section 11704(a)(2), "the Board [STB] *shall* annually determine which rail carriers are earning adequate revenues." The word "shall" clarifies that the STB has no option

50. See *R.R. Revenue Adequacy Chart 2024*, *supra* note 44.

51. *Coal Rate Guidelines*, *supra* note 21, at 38.

52. Rate Reform Task Force, REP. TO THE SURFACE TRANSP. BD. (April 25, 2019) at 33, <https://www.stb.gov/wp-content/uploads/Rate-Reform-Task-Force-Report-April-2019.pdf>.

53. *Bessemer & Lake Erie R. Co. v. United States*, 691 F.2d 1104, 1113 (3d Cir. 1982) ("While some other standard or combination of standards might also accomplish the overall objectives of the 4R and Staggers Acts, the choice among permissible alternatives is to be made by the agency to which rulemaking authority has been delegated, not by this court.").

54. *Id.*

55. The decision in *Bessemer* is protected by the "law of the circuit" doctrine. This doctrine "requires three-judge panels in the federal courts of appeals to give *stare decisis* effect to past decisions of the circuit, which can only be overruled by the circuit sitting en banc or by the U.S. Supreme Court." See Henry J. Dickman, Note, *Conflicts of Precedent*, 106 VA. L. REV. 1345, 1345 (2020).

56. 49 U.S.C. § 1174(a)(2).

57. See 5 U.S.C. § 706(2)(C).

in this matter. These “standards and procedures” are complex, and a simple ROI/COC formula is not sufficient compliance with the Act. To properly solve for the required financial targets and estimate what adequate revenues the carriers will need to accomplish system-wide objectives, a high-level team of experts in industry operations, rail transportation, economics, and finance is necessary. The establishment of such a team is the only way the STB will have the opportunity to be in compliance with this section of the Act. This, in turn, requires the STB to budget for the establishment of this team and its ongoing work.

IV. EARNING MORE THAN ADEQUATE REVENUES

From time to time, the STB raises the idea that, under the Act, carriers should not earn more than adequate revenues. For example, in its Rate Guidelines--Non-Coal Proceedings, the STB stated that “the statutory objective is for railroads to attain only the level of revenues that would be adequate under honest, economical, and efficient management”⁵⁸ This raises a critical legal question: Does the Act allow the STB to impose limits on the ability of carriers to earn greater than adequate revenues? Such a limit would certainly interfere with a carrier’s ability to achieve system-wide objectives as discussed in Part III. Fortunately, the answer to the question is a resounding no.

A. THE OMITTED-CASE CANON AND THE MAJOR QUESTIONS DOCTRINE

In the Act, there is no implicit or explicit statutory limitation on the amount of revenues that a carrier can earn.⁵⁹ Therefore, no limitation should be read into the Act. This textualist reading is based on the omitted-case canon: “Nothing is to be added to what the text states or reasonably implies (*casus omissus pro omissis habendus est*). That is, a matter not covered is to be treated as not covered.”⁶⁰ The result is that “the absent provision cannot be supplied by the courts”⁶¹ or a regulator. In sum, there is no provision in the Act that proscribes any type of upper bound on the amount of revenue that a carrier can earn.

Consistent with the omitted-case canon is the application of the major questions doctrine. This is a legal doctrine which limits an agency’s power to act on issues of “economic and political significance” without clear

58. SURFACE TRANSP. BD. REP., EX PARTE No. 347 (SUB- No. 2), RATE GUIDELINES-NON-COAL PROCEEDINGS, at 1027 (Dec. 27, 1996).

59. This textual reading of the Act is in agreement with the purposive approach taken by Macher, Mayo, and Pinkowitz: “Our reading of the Staggers Act and its legislative history finds no such congressional intent to restrict railroads’ earnings to be only those deemed adequate.” See Macher, et. al., *supra* note 11, at 122.

60. ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 90 (West, 2012).

61. *Id.* at 91.

authorization from Congress.⁶² According to Justice Amy Coney Barrett, the major questions doctrine “serves as an interpretive tool reflecting ‘common sense as to the manner in which Congress is likely to delegate a policy decision of such economic and political magnitude to an administrative agency.’”⁶³

Any restrictions on the ability of carriers to earn beyond-adequate revenues would have a significant economic impact on said carriers and on persons and institutions investing in the equity securities of those companies, buying their debt securities, and providing them with loans.⁶⁴ Such a cap on revenues would also be politically significant. This is based on the ongoing political debate,⁶⁵ recently fueled by the current Trump Administration’s war on regulation, that seeks clarity on how much federal government regulation businesses and consumers must endure. Through executive order, the Administration is seeking to reduce the level of regulation at all federal departments and agencies.⁶⁶ This would include the regulations the STB has issued in its own right and those that it has inherited from the ICC.⁶⁷

In sum, any attempt by the STB to put an upper bound on the ability of carriers to earn revenues may run afoul of the major questions doctrine.

B. NEGOTIATED RATES UNDER THE ACT

The omission of statutory language imposing a revenue cap is also consistent with Section 10709 of the Act, the operative section that allows carriers to enter into long-term customized contracts that cannot be reviewed by the STB:

- (a) One or more rail carriers providing transportation subject to the jurisdiction of the Board under this part may enter into a contract with one or more purchasers of rail services to provide specified services under specified rates and conditions.

62. *West Virginia v. EPA*, 597 U.S. 697, 700 (2022) (“[O]ur precedent teaches that there are ‘extraordinary cases’ that call for a different approach—cases in which the ‘history and the breadth of the authority that [the agency] has asserted,’ and and the ‘*economic and political significance*’ of that assertion, provide a ‘reason to hesitate before concluding that Congress’ meant to confer such authority.”) (emphasis added).

63. *Biden v. Nebraska*, 600 U.S. 477, 511 (2023) (Barrett, J., concurring) (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)).

64. See generally McCullough, *supra* note 28, at 4, 26, 36.

65. *Dissecting the Debate Over Regulation*, THE REGUL. REV. (Oct. 3, 2018), <https://www.theregreview.org/2018/10/03/dissecting-debate-regulation/>.

66. See Presidential Memoranda, *supra* note 22, at 1–3.

67. See HENRY B. HOGUE, CONG. RSCH. SERV., R47897, ABOLISHING A FEDERAL AGENCY: THE INTERSTATE COMMERCE COMMISSION 1, 22–23 (2024).

(b) A party to a contract entered into under this section shall have no duty in connection with services provided under such contract other than those duties specified by the terms of the contract.

(c)(1) A contract that is authorized by this section, and transportation under such contract, shall not be subject to this part, and may not be subsequently challenged before the Board or in any court on the grounds that such contract violates a provision of this part.⁶⁸

Hypothetically, all freight rail rates could be established via contract. If so, it is quite possible that one or more carriers could utilize “differential pricing” (discussed in Section 2 of this Part) to establish rates that would earn them more than adequate revenues. Moreover, under Section 10709(c) (1), such rates could not be reviewed by the STB. Such a potential outcome adds support for the argument that a carrier’s revenues cannot be legally capped under the Act, even if it leads to the carrier earning revenues that are more than adequate.

1. *The Meaning of Reasonable Rates*

In addition to the operative language found in Section 10709 of the Act, we also find strong support for negotiated contract rates in the Rail Transportation Policy section of the statute: “In regulating the freight railroad industry, it is the policy of the United States Government to allow, to the maximum extent possible, competition and the demand for services to establish *reasonable rates* for transportation by rail.”⁶⁹

This policy statement, along with the operative language discussed above, has totally changed our understanding of what is meant by “reasonable rates.”⁷⁰ Prior to October 14, 1980, the date the Act was made effective, reasonable rates were primarily set by the then existing regulator, the ICC.⁷¹ But since the Act’s effective date, the operative provisions of the Act have allowed reasonable rates to be established through confidential private contracting between railroad and shipper without review by the regulator.⁷² Such contracts can be customized as needed and allow for differential pricing.⁷³ Contracting has been estimated to account for approximately 76 percent of all railroad freight shipments.⁷⁴

68. 49 U.S.C. § 10709(a)-(c)(1).

69. 49 U.S.C. § 10101(1) (emphasis added).

70. *See id.*

71. *See* HOGUE, *supra* note 67, at 1, 5, 7.

72. 49 U.S.C. § 10709(c)(1).

73. *Id.*; 49 U.S.C. § 10101(1).

74. U.S. GOV’T ACCOUNTABILITY OFF., GAO-17-166, FREIGHT RAIL PRICING: CONTRACTS PROVIDE SHIPPERS AND RAILROADS FLEXIBILITY, BUT HIGH RATES CONCERN SOME SHIPPERS 14 (2016).

According to Mayo, Macher, and Sappington:

[A]ll freight rail traffic was subject to common carrier regulation prior to the Staggers Act. Under this regulatory regime, freight rail carriers posted a generally available price for shipments with particular characteristics. This price was subject to regulatory approval and, once published, was available to all customers (shippers) who wished to avail themselves of that price. With the passage of the Staggers Act, railroads were freed to establish prices that reflected prevailing market conditions, and were granted the authority to negotiate and implement Pareto-improving contracts with shippers. These contracting changes permitted railroads and shippers to expand the dimensionality of the terms under which they could engage in business, including quality and other special service levels.

The Staggers Act thus permitted a choice between two distinct exchange governance mechanisms: tariffs (akin to spot market prices) and contracts. Railroads continued to offer a menu of set prices that are still referred to as “tariffs” in the industry for shipments between specific origins and destinations. As with pre-Staggers Act tariffs, post-Staggers Act tariffs are not customer-specific, and service quality generally is determined by standard service provisions (so-called “best-efforts”) of the rail carrier involved. Moreover, for certain commodities, regulations still require that railroads offer a tariffed rate of service: a common carrier obligation. In the wake of the Staggers Act, however, tariffs have evolved into a mechanism akin to a simple public pricing document that enunciates the terms under which service will be provided. Post-Staggers Act prices are, absent regulatory intervention, set by the rail carrier and can change as prevailing market conditions change . . .

Unlike tariffs, contracts are customized for particular shippers, reflecting mutually agreed-upon prices and levels of service quality. The terms of these contracts can be kept confidential and are legally enforceable.⁷⁵

In sum, the modern practice is for reasonable rates to be established by railroads (“carriers”) and shippers entering into long-term contracts without fear of review or revocation by a regulator.⁷⁶ The result is a greater opportunity to earn more than adequate revenues.

75. Jeffrey T. Macher, John W. Mayo & David E.M. Sappington, *The Evolution of Contracting: Evidence From the U.S. Freight Rail Industry*, 41 J. OF L., ECON., & ORG. 316, 323 (2023).

76. TRACY C. MILLER, THE CASE FOR CONTINUED LIGHT-TOUCH REGULATION OF FREIGHT RAILROADS, MERCATUS CTR. FOR POL'Y RSCH. 6 (2022); see Macher, et. al., *supra* note 75, at 321 (up until 1978, the contracting between carriers and shippers was deemed to be per se illegal).

2. Differential Pricing

Freedom to contract without regulatory review allows carriers to utilize differential pricing⁷⁷ when negotiating rates with shippers.⁷⁸ Differential pricing allows carriers with varying degrees of market power (less than perfect competition) over their transportation routes to charge shippers different rates depending on their willingness to pay.⁷⁹ This permits carriers to cover their high fixed costs of operation even when long-term average costs (total cost of shipping service divided by the number of units of shipping service) are greater than long-term marginal costs (the incremental cost of producing an additional unit of shipping service).⁸⁰ Covering these high levels of fixed costs are necessary in order to allow railroads to achieve adequate revenues and potentially more. The following example demonstrates how differential pricing works:

Imagine a railroad that has total fixed costs of \$200 and serves three shippers: a package company, a grain elevator and a coal-fired power plant. For simplicity, assume the railroad's variable costs to serve each shipper is \$100.

Assume the package company will pay no more than \$130 for rail service — anymore, and it will switch to truck. The grain elevator will pay no more than \$170 — at a higher rate, it will lose its sales to grain grown elsewhere. The power plant is willing to pay more — \$200 — for rail service.

The railroad prices differentially by charging the package company and the grain elevator less than the power plant . . . The railroad covers its total costs, and each shipper makes a different contribution to the railroad's fixed costs.⁸¹

C. SUMMARY

The Act does not provide for any implicit or explicit statutory limitation on the amount of revenues that a carrier can earn.⁸² Therefore, no

77. A differential pricing approach as a means to earn adequate revenues is explicitly discussed in the Act under the discussion of voluntary rate arbitration proceedings: “[i]n resolving a covered dispute involving the reasonableness of a rail carrier's rates, the arbitrator or panel of arbitrators, as applicable, shall consider the Board's methodologies for setting maximum lawful rates, giving due consideration to the need for differential pricing to permit a rail carrier to collect adequate revenues (as determined under section 10704(a)(2)).” See 49 U.S.C. § 11708.

78. Macher, et. al., *supra* note 75, at 322.

79. U.S. DEP'T OF AGRIC. & U.S. DEP'T OF TRANSP., STUDY OF RURAL TRANSPORTATION ISSUES 352–53 (2010).

80. MILLER, *supra* note 76, at 13–14.

81. *Id.* at 14.

82. See generally 49 U.S.C. §§ 10101–11908.

limitation should be read into the Act. This is an application of the omitted-case canon and the major questions doctrine. The Act also encourages carriers and shippers to enter into contracts that are non-reviewable by the STB. This allows carriers to enter into differential pricing. As long as both the carrier and shipper contractually agree, the statute finds such a negotiated rate to be reasonable. Unlike operating in a regulated rate environment, if the railroads negotiate in an optimal manner, such pricing may theoretically lead to the earning of adequate revenues or more. In sum, any type of cap imposed by the STB on the revenues earned by a carrier would be beyond the STB's statutory authority and, as a result, be in violation of Section 706(2)(C) of the APA.⁸³

V. ADEQUATE REVENUES AND REASONABLE RATES IN MARKET DOMINANT SITUATIONS

While the Act creates optimal conditions for a carrier and a shipper to establish reasonable rates through a negotiated contract, entering into a contract is not required. Moreover, a shipper can subject a carrier's offered rates to STB review and possible reduction if it can demonstrate "market dominance" — "an absence of effective competition from other rail carriers or modes of transportation [trucking, sea shipping, air shipping, etc.] for the transportation to which a rate applies."⁸⁴ Such a shipper is referred to as a "captive shipper" (non-statutory term) since it has no alternative but to use the carrier to ship its goods.⁸⁵

The ability of a shipper to appeal a carrier's offered rate in market dominant situations brings up an issue that has been around since the ICC promulgated its Coal Rate Guidelines in 1985 — Can the successful earning of adequate revenues be used as a factor in reducing the STB's rate determination in market dominant situations?⁸⁶ As discussed below, the answer is another resounding no.

The resolution of that issue requires a close look at the statutory language. This analysis begins with a review of Section 10707 of the Act.⁸⁷ This operative section lays out the STB's authority, and the limitations to its authority, that is provided to the agency in its regulatory determination of reasonable rates.⁸⁸ Then, policy statement number six of the Rail

83. 5 U.S.C. § 706 ("[t]he reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . *in excess of statutory jurisdiction, authority, or limitations, or short of statutory right* . . .") (emphasis added). See also *Citizens Comm. for Hudson Valley v. Volpe*, 425 F.2d 97, 101 (2d Cir. 1970) ("[s]ection 706(2)(C) permits the reviewing court to set aside agency action found to exceed the agency's statutory authority.").

84. 49 U.S.C. § 10707(a).

85. *Burlington N. & Santa Fe Ry. v. Surface Transp. Bd.*, 453 F.3d 473, 476 (D.C. Cir. 2006).

86. *Consol. Rail Corp. v. United States*, 812 F.2d 1444, 1455 (3rd Cir. 1987) (including shipper's argument that the ICC guidelines give too much weight to revenue adequacy).

87. See 49 U.S.C. § 10707.

88. See *CSX Transp., Inc. v. Surface Transp. Bd.*, 774 F.3d 25, 27 (D.C. Cir. 2014).

Transportation Policy section of the Act is closely scrutinized to see if it has any significance in resolving this issue.⁸⁹ This statement provides the policy objective that reasonable rates be offered “where rail rates provide revenues which *exceed* the amount necessary to maintain the rail system and to attract capital.”⁹⁰

A. STATUTORY FRAMEWORK

Under Section 10707 of the Act, when a petitioner has established market dominance, the STB will proceed to determine the statutorily required *reasonable maximum for that transportation*.⁹¹

When the Board finds in any proceeding that a rail carrier proposing or defending a rate for transportation has market dominance over the transportation to which the rate applies, it may then determine that rate to be unreasonable if it exceeds *a reasonable maximum for that transportation*. However, a finding of market dominance does not establish a presumption that the proposed rate exceeds a reasonable maximum.⁹²

If the rate offered by the carrier is beyond that *reasonable maximum*, then they are unreasonable and subject to reduction by the STB.⁹³ However, the statute does provide carriers with a safe harbor.⁹⁴ A captive shipper must also demonstrate that the “revenue-variable cost percentage”⁹⁵ of the disputed service is 180 percent or greater.⁹⁶ When a ratio is less than 180 percent, there is no market dominance for purposes of challenging a rate.⁹⁷

89. 49 U.S.C. § 10101(3).

90. 49 U.S.C. § 10101(6).

91. 49 U.S.C. § 10707(c).

92. *Id.*

93. *Id.*

94. *Burlington N. & Santa Fe Ry. v. Surface Transp. Bd.*, 526 F.3d 770, 775 (D.C. Cir. 2008).

95. This ratio is not defined in the statute. However, it can be understood in the context of a single lane of service, “the railroad’s revenue divided by the operating cost for that lane.” See *Railroad Operating Ratio and How They Price*, RSI LOGISTICS (Apr. 26, 2024), <https://www.rsilogistics.com/blog/how-railroads-price-shipping/>. The Act is very clear on how variable costs are to be calculated: “For purposes of this section, variable costs for a rail carrier shall be determined only by using such carrier’s unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board.” 49 U.S.C. § 10707(d)(1)(B).

96. 49 U.S.C. § 10707(d)(1)(A).

97. *Id.*; See BEN GOLDMAN, CONG. RSCH. SERV., R47013, THE SURFACE TRANSPORTATION BOARD (STB): BACKGROUND AND CURRENT ISSUES 4 (2022) (“There have been 51 rail rate cases brought before STB since its creation. STB has issued a reasonableness ruling in under half of these; the remainder were either withdrawn or settled by the parties before STB issued a decision.”).

In making a determination under this section, the Board shall find that the rail carrier establishing the challenged rate does not have market dominance over the transportation to which the rate applies if such rail carrier proves that the rate charged results in a revenue-variable cost percentage for such transportation that is less than 180 percent.⁹⁸

Moreover, even if the safe harbor ratio is exceeded, the STB may still find the offered rate not to exceed a reasonable maximum.⁹⁹

A finding by the Board that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than 180 percent does not establish a presumption that—

(A) such rail carrier has or does not have market dominance over such transportation; or

(B) the proposed rate exceeds or does not exceed a reasonable maximum.¹⁰⁰

What is notable about the rate setting framework presented in Section 10707 is that there is no mention of adequate revenues or Section 10704, the operative section on adequate revenues.¹⁰¹ Conversely, when we look at Section 10704, there is no reference to rate setting in market dominant situations or Section 10707.¹⁰² Therefore, there is no statutory link that provides the STB with authority to create a regulation, such as discussed in Section C of this Part, that allows for the limiting or capping of a reasonable maximum rate just because a carrier is earning adequate revenues. Again, we can look to the omitted case canon for a rationale for this lack of authority: “Nothing is to be added to what the text states or reasonably implies (*casus omissus pro omissis habendus est*). That is, a matter not covered is to be treated as not covered.”¹⁰³

Conversely, there is clear statutory language, Section 10701(d),¹⁰⁴ that requires the STB to make sure that its rate reasonableness review does not result in a carrier earning less than adequate revenues:

(1) If the Board determines, under section 10707 of this title, that a rail carrier has market dominance over the transportation to which

98. 49 U.S.C. § 10707(d)(1)(A).

99. 49 U.S.C. § 10707(d)(2)(B).

100. 49 U.S.C. § 10707(d)(2).

101. 49 U.S.C. §§ 10704, 10707.

102. *Id.*

103. SCALIA & GARNER, *supra* note 60, at 93.

104. 49 U.S.C. § 10701(d).

a particular rate applies, the rate established by such carrier for such transportation must be reasonable.

(2) In determining whether a rate established by a rail carrier is reasonable for purposes of this section, the Board shall give due consideration to . . . recognizing the policy of this part that rail carriers shall earn adequate revenues, as established by the Board under section 10704(a)(2) of this title.¹⁰⁵

In sum, there is nothing in the operative language of Sections 10707 or 10704 that states or implies that a STB determination that a carrier is earning adequate revenues is to be a limiting or capping factor in the STB's rate setting in market dominant situations.¹⁰⁶ If the earning of adequate revenues is to be used as a constraint in rating setting, it must be found elsewhere in the statute.

B. RAIL POLICY STATEMENT NO. 6

A policy statement can help fill in the blanks where the operative language is ambiguous. As stated by the Supreme Court in *Yazoo & Miss. Valley R.R. v. Thomas*, "the preamble is no part of the act" and therefore "cannot enlarge or confer powers, nor control the words of the act, unless they are doubtful or ambiguous."¹⁰⁷ According to the 7th Circuit in *Jogi v. Voges*:

Whether or not we are reading the Preamble correctly, there is a broader principle at stake. It is a mistake to allow general language of a preamble to create an ambiguity in specific statutory or treaty text where none exists. Courts should look to materials like preambles and titles only if the text of the instrument is ambiguous.¹⁰⁸

This approach is referred to as the Prefatory-Materials Canon— "A preamble, purpose clause, or recital is a permissible indicator [but only an indicator] of meaning."¹⁰⁹ For example, policy statement no. 6 in The Rail Transportation Policy section of the Act states:

In regulating the railroad industry, it is the policy of the United States Government to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which

105. 49 U.S.C. § 10701(d)(1)-(2).

106. 49 U.S.C. §§ 10704, 10707.

107. *Yazoo & Miss. Valley R.R. v. Thomas*, 132 U.S. 174, 188 (1889).

108. *Jogi v. Voges*, 480 F.3d 833, 834 (7th Cir. 2007).

109. SCALIA & GARNER, *supra* note 61, at 219.

exceed the amount necessary to maintain the rail system and to attract capital[.]¹¹⁰

Parsing this statement begins with noting that the “absence of effective competition” implies that it is talking about STB rate setting in market dominant situations.¹¹¹ If so, this will help us to interpret any ambiguities found in Section 10707. However, it only comes into play when the carrier is earning more than “the amount necessary to maintain the rail system and to attract capital.”¹¹² Looking at the language of Section 11704, this must mean earning more than adequate revenues. If so, the policy guidance provided is that revenue adequacy can come into play in rate setting, but only when it is shown that a railroad is making more than adequate revenues.¹¹³ Making just adequate revenues is not enough to trigger a regulatory rate constraint, it must be demonstrated that a carrier is earning more than adequate revenues.

To be consistent with this policy statement, the STB will need to determine when a Class I railroad is making “excess” adequate revenue. As discussed in Part III, the STB is not currently determining revenue adequacy that is in compliance with the Act.¹¹⁴ To make a compliant determination would require the STB to investment significant resources. Being required to make this additional determination would require even more resources. These are tall hurdles for the STB to jump over.

That said, interpreting this policy statement is an interesting exercise, but no more. The statement is limited to only interpreting ambiguities found in the operative language. There are simply no ambiguities to resolve in Section 10707 that involve a carrier earning revenues let alone earning adequate revenues or revenues that go beyond adequate. Therefore, this policy statement has no relevance in this legal analysis.

In sum, the use of adequate revenues as a limiting or capping factor in the STB’s determination of a reasonable maximum in market dominant situations would be beyond the STB’s statutory authority and therefore in violation of Section 706(2)(C) of the APA. This conclusion has direct implications for the current regulatory regime for such determinations. This will be discussed below in Section C.

C. REVENUE ADEQUACY CONSTRAINT

The regulatory approach used to implement Section 10707 is referred to as “constrained market pricing (“CMP”) and can be found in the Coal

110. 49 U.S.C. § 10101(6).

111. Ass’n of Am. R.R. *Freight Rail Economic Regulation*, <https://www.aar.org/issue/freight-rail-economic-regulation/>.

112. 49 U.S.C. § 10101(a)(6).

113. RATE REFORM TASK FORCE, REP. TO THE SURFACE TRANSP. BD. 7 (2019).

114. *See supra* Part III.

Rate Guidelines (“Guidelines”).¹¹⁵ CMP is intended to apply “competitive pricing principles” to STB rate setting in order to protect captive shippers from “‘monopolistic’ pricing practices.”¹¹⁶ The Guidelines, since expanded to apply to all such rate determinations, not just coal shipping rates,¹¹⁷ were promulgated under the Act in 1985 when the ICC was still the industry regulator.¹¹⁸ In 1995, upon elimination of the ICC and creation of the STB, the Guidelines were inherited by the STB.¹¹⁹

According to the Guidelines:

The objectives of CMP can be simply stated. *A captive shipper should not be required to pay more than is necessary for the carrier(s) involved to earn adequate revenues.* Nor should it pay more than is necessary for efficient service. A captive shipper should not bear the costs of any facilities or services from which it derives no benefit. Responsibility for payment for facilities or services which are shared (to its benefit) by other shippers should be apportioned according to the demand elasticities of the various shippers. Thus railroads would be given incentives to ensure that competitive traffic contributes as much as possible toward these costs. Finally, changes in the rate structure should not be so precipitous as to cause severe economic dislocations.¹²⁰

The italicized sentence in the quote above introduces the first constrained rate determination approach found in the Guidelines—the “Revenue Adequacy Constraint” (“RAC”).¹²¹ The Guidelines provide the following description of the RAC:

Our revenue adequacy standard represents a reasonable level of profitability for a healthy carrier. It fairly rewards the rail company’s investors and assures shippers that the carrier will be able to meet their service needs for the long term. *Carriers do not need greater revenues*

115. *Coal Rate Guidelines*, *supra* note 21.

116. *Id.* at 41.

117. Expedited Procedures for Processing Simplified Rail Rate Reasonableness Proceedings, 62 Fed. Reg. 50550, at n.3 (proposed Sept. 26, 1997) (“Notwithstanding its title, Coal Rate Guidelines procedures are not limited to coal cases. Rather, the guidelines are the preferred method of evaluating the reasonableness of any rate.”).

118. *Id.*

119. See HOGUE, *supra* note 67, at 22–23.

120. *Coal Rate Guidelines*, *supra* note 21, at 9 (emphasis added).

121. *Id.* at 13 (discussing three other constraints discussed in the Guidelines: 1) the management efficiency constraint; 2) the stand-alone cost constraint; and 3) the phasing constraint. Historically, the stand-alone cost constraint has primarily been used in rate cases); see *Quarterly Report on Rate Complaint Cases Q1 2025*, SURFACE TRANSP. BD., <https://www.stb.gov/wp-content/uploads/Final-1Q-Report-on-Rate-Case-Review-Metrics-2025.pdf>; Russell Pittman, *Against the Stand-Alone-Cost Test in U.S. Freight Rail Regulation*, 38 J. REG. ECON. 313 (2010) (discussing the stand-alone cost constraint and its limitations).

than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues. Therefore, the logical first constraint on a carrier's pricing is that its rates not be designed to earn greater revenues than needed to achieve and maintain this "revenue adequacy" level. In other words, captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future services needs.¹²²

This paragraph reads Section 10707 to mean that the STB has the authority to limit or cap rate setting in market dominant situations *if* a carrier is determined to earn adequate revenues.¹²³ As subsequently discussed, there is no authority in Section 10707 or in any other section of the Act, either explicit or implicit, that provides for such a reading. In sum, sub-section 2 will argue that RAC is an unauthorized approach to CMP.¹²⁴

1. *History of the RAC*

Even though the RAC was introduced forty years ago and captive shippers have been eager to use this constraint in rate setting in market dominant situations, it has yet to be utilized in rate determinations.¹²⁵ This is so for two reasons. First, for approximately the first twenty-five years of the Act, the STB's revenue adequacy determinations did not show that Class I carriers were earning adequate revenues.¹²⁶ However, this started changing in 2004 and in subsequent years, when the STB's annual determinations started showing that some or even a majority of the Class I railroads

122. *Coal Rate Guidelines*, *supra* note 21, at 37–38 (emphasis added).

123. See 49 U.S.C. § 10701(d) (coming with the statutory caveat, as discussed in Section A of this Part, that the maximum allowable rate determined shall not cause the carrier to earn less than adequate revenues).

124. See Salvatore Massa, *Surface Freight Transportation: Accounting for Subsidies in a "Free Market"*, 4 J. LEGIS. AND PUB. POL'Y 285, 302 at n.94 (assuming the authority for RAC actually existed, the last sentence of the quote above states that the STB will constrain its rate determinations for a carrier who is earning adequate revenues by not allowing the use of differential pricing. That is, a shipper's willingness to pay based on its unique elasticity of demand (the more inelastic the higher the rate), can no longer be a relevant factor in rate determinations when a carrier is revenue adequate. Supposedly, such a constraint will help make sure that the carrier does not earn more than adequate revenues off the back of a captive shipper with a high level of inelastic demand for the services of a carrier with market dominance).

125. Railroad Revenue Adequacy: Petition of the Western Coal Traffic League to Institute a Rulemaking Proceeding To Abolish the Use of the Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Equity Capital, 79 Fed. Reg. 19042, 19043 (proposed Apr. 7, 2014) ("The Board has not yet had the opportunity to address how the revenue adequacy constraint would work in practice in large rail rate cases . . . The few revenue adequacy-based complaints have either settled or involved other transportation modes."). See also *Quarterly Report*, *supra* note 121.

126. See *Quarterly Report*, *supra* note 121.

were revenue adequate.¹²⁷ In the most recent determination, three Class I railroads were found to be revenue adequate.¹²⁸ Second, the STB has yet to provide guidance on how the RAC would be implemented in practice. However, in April 2014, the STB opened an informational docket to obtain public comment on how such implementation could be accomplished.¹²⁹ Frustrated by the lack of progress on this issue, the Western Coal Traffic League (“WCTL”), in 2022, petitioned the Board to develop a proposed rule on how the earning of adequate revenues can be used “by shippers challenging the reasonableness of rates charged on market dominant rail traffic.”¹³⁰

The STB has not followed up on creating such a rule even after the WCTL filed a writ of mandamus with the United States Court of Appeals for the District of Columbia Circuit asking the court to compel the STB to do so.¹³¹ The DC Circuit recently found that the STB was not compelled to do so.¹³²

2. *The Act and RAC*

The STB’s refusal to create a rule on how RAC would actually be applied in maximum allowable rate determinations turns out to be the correct regulatory approach. This is based on two legal arguments that we have already discussed. First, as discussed in Part III of this Article, the STB’s annual determination of whether a carrier is earning adequate revenues as required by Section 10704(a)(3) does not sufficiently utilize the meaning of adequate revenues as found in Section 10704(a)(2) of the Act.¹³³ The STB’s revenue adequacy determinations find a carrier to be earning adequate revenues if it achieves a ROI equal to at least the COC for the railroad industry.¹³⁴ This simple formula does not even come close to approximating the complex definitional requirements of Section 10704(a)(2).¹³⁵ There-

127. *R.R. Revenue Adequacy Chart 2023*, SURFACE TRANSP. BD., <https://www.stb.gov/wp-content/uploads/Revenue-Adequacy-Chart-2023.pdf>.

128. *R.R. Revenue Adequacy Chart 2024*, *supra* note 44.

129. Notice on STB Dkt. EP 722, R.R. Revenue Adequacy, 79 Fed. Reg. 19042 (Apr. 1, 2014).

130. Petition for Admin. Action by the W. Coal Traffic League to the Surface Transp. Bd. at 1 (Aug. 24, 2022).

131. Petition for Writ of Mandamus at 4, In re: W. Coal Traffic League, No. 23-1126 (May 5, 2023).

132. In re: W. Coal Traffic League, No. 23-1126, *11 (D.C. Cir. July 26, 2024).

133. *See supra* Part III(A).

134. *Id.*

135. A great example of how the STB ignores the complexity of determining revenue adequacy and compounds its mistake by relying on backward-looking data can be found in a relatively recent rate reasonableness decision. The STB started from its non-compliant annual revenue adequacy determinations, which suggested that the carrier was revenue inadequate over a backward-looking long-term time frame. *See Consumers Energy Co. v. CSX Transp., Inc.*, No. NOR 42142, slip op. at 4 (STB served Jan. 11, 2018). Based on precedent, it allowed the shipper to provide additional financial ratio evidence in order to demonstrate that the carrier was revenue adequate.

fore, these determinations must be considered worthless for determining if a carrier is actually earning adequate revenues. In sum, use of these determinations as rationales for implementing the RAC would most likely be found to be an arbitrary and capricious act under Section 706 of the APA.

Alternatively, and most importantly, even if revenue adequacy determinations could be calculated in conformity with the Act, there is nothing in the Act's operative language that states or implies that the earning of adequate revenues are to limit or cap STB's rate determinations in market dominant situations.¹³⁶ Doing so would be beyond the statutory authority of the STB; if it were to do so, such an act would likely be found in violation of the APA.

D. RECOMMENDATION TO ELIMINATE RAC FROM GUIDELINES

Because it lacks statutory authority, the RAC needs to be eliminated as one of the four constraints used in the STB's determination of reasonable maximum allowable rates under market dominance. The STB should rescind under APA guidelines¹³⁷ the sections of the Guidelines that discuss and provide for RAC. This would be consistent with the Trump executive order that seeks the repeal of regulations "that clearly [exceed] the agency's statutory authority or [are] otherwise unlawful."¹³⁸ The use of the RAC clearly exceeds the STB's statutory authority. Rescinding RAC would also allow the STB to conserve resources by eliminating the need to respond to recurring, though irregular, calls to use the agency's statutorily insufficient revenue adequacy determinations in rate-setting decisions.

E. RECOMMENDATION TO REVISE THE THREE-BENCHMARK TEST

Under Section 10701(d)(3) of the Act,¹³⁹ the STB is to provide one or more simplified methods for determining rates in market dominant situations. One of those methods promulgated by the STB is the three-benchmark test.¹⁴⁰ Professor Gerald McCullough provides the following description of the test:

Id. ("[The STB's] precedent establishes that such determinations are not necessarily conclusive evidence of a railroad's revenue adequacy in rate reasonableness proceedings, which may include other competent and probative evidence relevant to that issue."). However, the added evidence was still backward looking and therefore did nothing to enhance the analysis. *Id.* at 5-6 (referencing examples of backwards-looking data). Moreover, it did not change the result that the carrier was revenue inadequate. *Id.* at 4. In sum, this determination was out of compliance with what the Act requires.

136. See generally Stagers Rail Act of 1980, 49 U.S.C. § 10101.

137. *Perez v. Mortg. Bankers Ass'n*, 575 U.S. 92, 101 (2015) ("[A]gencies [must] use the same [APA] procedures when they amend or repeal a rule as they used to issue the rule in the first instance").

138. Presidential Memorandum, *supra* note 22.

139. 49 U.S.C. § 10701(d)(3).

140. RATE GUIDELINES-NON-COAL PROCEEDINGS, *supra* note 58, at 1004.

A *Three-Benchmark Approach*, created for small rate cases, compares the revenue-to-variable-cost ratio for disputed traffic to three "benchmark" ratios on traffic that the STB staff judges to be "comparable." The benchmarks are all samples of railroad traffic where the revenue-to-variable cost ratios are greater than 180 percent. This is considered to be captive traffic.

The Revenue Shortfall Allocation Method (RSAM) Benchmark is the average R/VC ratio that all of a railroad's captive shippers would have to pay to provide coverage of the railroad's total fixed costs. The coverage in this case is determined by a four-year average of *annual revenue adequacy determinations*.

The R/VC_{COMP} Benchmark is the average ratio on captive commodities with qualities that are similar to the commodity at issue.

The R/VC₁₈₀ Benchmark is the average ratio for all captive traffic.¹⁴¹

The use of the RSAM benchmark allows for the constrained reasonable allowable rate to become a function of whether a carrier is earning adequate revenues.¹⁴² The greater the shortage below adequate revenues, the higher the reasonable allowable rate.¹⁴³ The higher the surplus above adequate revenues, the lower the reasonable allowable rate.¹⁴⁴ The lower bound being a revenue-to-variable cost ratio of 180 percent.¹⁴⁵

As argued above in Section C of this Part, the STB lacks statutory authority to limit or cap rate determinations based on the earning of adequate revenues. Accordingly, it must remove or modify the RSAM component to ensure it does not penalize a carrier for achieving revenue adequacy. How the three-benchmark test is to be modified based on this recommendation is beyond the scope of this Article.

VI. SUMMARY OF RECOMMENDATIONS

Economics plays a prominent role in the regulation of carriers.¹⁴⁶ Variable costs, fixed costs, marginal costs, capital, economic return and profit, etc. are key economic terms for understanding the Act.¹⁴⁷ In CMP, the economic theories of "contestable markets" and "Ramsey pricing" play an important role in rate setting.¹⁴⁸ Yet, before the STB can apply specific eco-

141. McCullough, *supra* note 28, at 24 (emphasis added).

142. Macher et al., *supra* note 11, at 100-01.

143. *Id.* at 100.

144. *Id.*

145. *Id.*

146. Coal Rate Guidelines, *supra* note 21, at 9.

147. *Id.* at 73-74.

148. *Id.* at 16-20.

conomic terms or theories in its regulations, it must have a clear understanding of its statutory authority. The following summary of recommendations (found in Parts III and V of this Article) are meant to address situations where current STB regulations are not in alignment with the STB's statutory authority:

- In Section B of Part III, it was argued that the STB's annual revenue adequacy determinations for Class I railroads are nowhere close to what the Act requires. Therefore, these determinations must be considered worthless for any type of regulatory use. To properly solve for the required financial targets and estimate what adequate revenues the carriers will need to accomplish system-wide objectives, a high-level team of experts in industry operations, rail transportation, economics, and finance is necessary. The establishment of such a team is the only way the STB can become compliant with the Act. This, in turn, requires the STB to budget for the establishment of this team and its ongoing work.
- In Section D of Part V it was argued that because of a lack of statutory authority to include revenue adequacy in the STB's rate determinations in market dominant situations, the RAC needs to be eliminated as one of the four constraints used in CMP. This can be done by the STB rescinding the sections of the Guidelines that discusses and provides for RAC. This would be consistent with the Trump executive order that seeks the repeal of regulations that are unlawful.
- In Section E of Part V it was also argued that this lack of statutory authority requires the STB to modify or remove RSAM from its three-benchmark test. A carrier should not be penalized for achieving revenue adequacy under this test. How the test is to be modified based on this recommendation is beyond the scope of this Article.

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