Testing The Limits On State Regulation Of Crude Oil By Rail

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Law360, New York (November 25, 2015, 10:50 AM ET) - There is growing tension between steps taken by state and local officials to protect their constituents from perceived risks associated with the transportation of crude oil by rail and the pervasive and comprehensive federal authority over the railroad industry that strongly favors national, uniform, federal rules.

Over the last five years, the railroad industry has experienced a surge in demand for transportation of crude oil by rail. This demand peaked in 2014, with the industry carrying almost half a million carloads annually. While demand fell notably in 2015, the amount of crude oil shipped by rail remains well above historic levels. The freight railroads as regulated common carriers are legally obligated to transport crude oil upon reasonable request.

The surge in demand was accompanied by a rise in local concerns about the safety of these shipments. Virtually all shipments of crude oil by rail reach their destination safely. The U.S. Department of Transportation has reported that 99.9 percent of all crude oil shipments arrive safely at their destinations. But following the tragic accident in Lac Megantic, Canada, involving a runaway train of crude oil, and several other well-publicized derailments where there were spills but no fatalities, state and local officials began to explore what steps they could take to address the perceived risk of crude oil rail transportation.

The obstacles facing these officials, however, are a number of federal statutes designed to promote safety and equal access to rail service by preempting most state and local regulations of rail transportation. Congress' assertion of federal authority over the railroad industry is "among the most pervasive and comprehensive of federal regulatory schemes."[1] As a result, the U.S. Constitution's Supremacy Clause preempts state or local regulations that are inconsistent with this pervasive federal regulatory scheme.

Three overlapping federal statutes provide the foundation for most federal preemption claims related to the transportation of crude oil by rail. First, the Federal Railroad Safety Act prevents states from supplementing federal safety laws once the DOT has prescribed regulations or issued orders that cover the subject matter.

Second, the Hazardous Materials Transportation Act has its own independent preemption provisions that relate specifically to the transportation of hazardous materials. This law has various protections that Congress put in place "to preclude a multiplicity of state and local regulations and the potential for varying as well as conflicting regulations in the area of hazardous materials transportation."[2]

Third, the ICC Termination Act contains a "broad and sweeping" preemption provision that blocks attempts to impinge on a railroad's ability to conduct rail operations. As the Senate explained when it enacted the ICCTA: "The hundreds of rail carriers that comprise the railroad industry rely on a nationally uniform system of economic regulation. Subjecting rail carriers to regulatory requirements that vary among the States would greatly undermine the industry's ability to provide the 'seamless' service that is essential to its shippers and would weaken the industry's efficiency and competitive viability."[3]

However, it can be hard to convince local officials that they cannot adopt a local regulation to address a local concern. Federal preemption laws are complicated. They involve a fact-specific inquiry into multiple statutory provisions and require an understanding of the pervasive federal regulatory scheme already in place.

Moreover, local officials may not appreciate the burden of a proposed local regulation. From their perspective, a single regulation is rarely viewed as imposing a serious burden on large freight railroads. The collective weight of dozens or hundreds of similar regulations by other local officials located along the railroad right of way — or the impossibility of complying with conflicting local requirements — goes largely ignored.

In response to the increase in crude oil shipments by rail, the railroad industry has witnessed a spectrum of regulatory efforts by local officials that range from the clearly permissible to the clearly not.

Included within the plainly permissible efforts are the actions of a number of state and local officials who took their concerns to Washington. They successfully persuaded federal regulators to adopt more stringent regulations of the transportation of crude oil and to roll out other safety measures. This approach resulted in uniform federal rules that avoid the risk and burdens of a hodgepodge of local regulations.

Other states worked collaboratively with the freight railroads to find mutually agreeable ways to further improve the safe transportation of crude oil by rail. Examples include states that studied ways to improve rail safety and then worked with freight railroads to implement feasible ideas. The railroad industry takes pride in its culture of corporate safety and has a long track record of working together with local officials to address local safety concerns. Seeking cooperative solutions avoid a patchwork of local regulations that could burden interstate commerce and drive commodities to other less safe forms of transportation.

But the railroad industry has also witnessed a noticeable increase in local regulations that disregard even well-established federal limitations. For example, several states are either contemplating or have adopted regulations to require freight railroads to prove they have sufficient financial means (i.e., insurance) before they transport crude oil though that state. This form of economic regulation was struck down by the U.S. Supreme Court decades ago as fundamentally inconsistent with the federal regulatory scheme.[4]

Indeed, states cannot require a showing of financial fitness even if they "merely" subject the railroads to civil penalties and disclaim the ability to stop trains carrying crude oil from operating. In Railroad Transfer Service Inc. v. City of Chicago,[5] the city of Chicago had adopted local regulations that would require certain transfer companies to obtain a permit from the city to operate. Part of the required showing for a city permit was evidence that the operator would have the "financial ability" to render "safe and comfortable" service, to replace and maintain equipment, and to pay all judgments arising out of vehicle operation.

In defending its regulations, the city argued that the permitting process did not conflict with the Interstate Commerce Act or burden interstate commerce. According to the city, obtaining the license was easy. The company only had to submit an application; pay a small licensing fee; and file a list of equipment, a financial statement, a corporate certificate of authorization, a certificate of insurance, and the corporate charter. Moreover, during the course of the litigation, the city conceded that if a company failed to obtain the permit, the city lacked the authority under Atchison to order the company to stop operations. The city could “only” fine them for noncompliance or arrest their employees.

The Supreme Court found this permitting process improper and unlawful. The court observed that “[t]hough the city now disclaims any power to ‘stop’ Transfer’s operations, it does not give up its power under the ordinance to fine Transfer and arrest its drivers for operating without licenses.”[6] The court reasoned “[h]ere the city seeks to enforce each and all of these related requirements by denial of a license for noncompliance and then criminal sanctions for operation without a license. This is the ‘veto power’ which Atchison held the city may not exercise.”[7]

There are other examples of local regulations directed at the transportation of crude oil that also test the boundaries of permissible local regulations. These examples include adopting regulations that appear to be preclearance requirements prohibited by ICCTA, duplicative safety regulations and reporting requirements preempted by FRSA, and discriminatory fees on the transportation of hazardous materials prohibited by HMTA. And there is a recent trend of regulations aimed at rail customers instead of the railroads themselves, to try to regulate indirectly what cannot be regulated directly.

Over the next few years, there will be a wave of preemption litigation if this trend continues. The Surface Transportation Board — the federal regulatory agency charged with administering the ICCTA — has already experienced a noticeable increase in requests for guidance on the scope of ICCTA preemption. Unless there is a sudden drop in the transportation of crude oil by rail, we can expect more local regulations to test the boundary between the permissible and impermissible.

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[1] Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 318 (1981).

[2] S.Rep. No. 1192, 93rd Cong., 2nd Sess. 37 (1974).

[3] S. Rep. No. 104–176, at 6 (1995), U.S.Code Cong. & Admin.News 1995, p. 793.

[4] Chicago v. Atchison, T. & Santa Fe Ry. Co., 357 U.S. 77 (1958) (Atchison)

[5] 386 U.S. 351 (1967).

[6] Id. at 358.

[7] Id. at 360.