

Public Interest Comment¹ on
The Surface Transportation Board's Proposed Rules
Market Dominance Streamlined Approach, Docket No. EP-756,
Final Offer Rate Review Docket Nos. EP 755 and EP 665 (Sub-No. 2)

Solicitation of Information
Association of American Railroads – Petition for Rulemaking, Docket No. EP 752

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The George Washington University Regulatory Studies Center improves regulatory policy through research, education, and outreach. As part of its mission, the Center conducts careful and independent analyses to assess rulemaking proposals from the perspective of the public interest. This comment on the Surface Transportation Board's (STB's) proposed rules, "Market Dominance Streamlined Approach" and "Final Offer Rate Review," does not represent the views of any particular affected party or special interest, but is designed to evaluate the effect of the STB's proposals on overall consumer welfare and assist the board in identifying the primary impacts of the proposed rule and feasible alternatives. I am submitting the same comment in the dockets for these two rulemakings, plus the docket on the petition for a rulemaking on cost-benefit analysis, because the two proposals provide an excellent opportunity to illustrate how the regulatory impact analysis (RIA) framework I recommend could be used to answer critical questions the STB must answer to fulfill its statutory obligations.

Introduction

The Staggers Rail Act of 1980 deregulated most freight rail rates but left the Interstate Commerce Commission (and now the STB) with responsibility for ensuring that rail rates are "just

¹ This comment reflects the views of the author, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at <http://regulatorystudies.columbian.gwu.edu/policy-research-integrity>.

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and reasonable” for shippers who lack good transportation alternatives to a single railroad. The STB can regulate a rate if the shipper complains to the STB, the STB finds that the railroad is “market dominant” for the shipment(s) at issue, and the STB finds that the rate is not just and reasonable. The legislation that created the STB in 1995 instructed it to develop a method for simplified and expedited resolution of rate complaints that would be useful for small shipments.

The two rulemakings this comment addresses are the STB’s latest efforts to develop simpler and less costly rate complaint processes. The Market Dominance Streamlined Approach seeks to simplify and expedite market dominance determinations by establishing a list of six factors that would make a prima facie case that a railroad is market dominant in regard to a particular shipper. The proposal includes a 50-page limit on reply and rebuttal submissions, but no time limit on the proceedings.³ The Final Offer Rate Review proposal would establish a series of procedural deadlines intended to allow the STB to issue a decision 135 days after a rate complaint is filed for cases in which the shipper seeks rate relief of \$4 million or less. The railroad and the shipper would each be required to submit a final offer (as in baseball-style arbitration), and if the STB determines that the railroad has market dominance over the shipment(s) in question, it would select one of the offers without modification.⁴

Both of these proposals have significant merit, and I fully agree with the supportive comments and the suggested additions submitted by members of the Transportation Research Board’s Committee for a Study of Freight Rail Transportation and Regulation (TRB Study Committee), on which I served.⁵ I am submitting this separate comment to address an issue that goes beyond the topics addressed in that study committee’s report: namely, the appropriate analytical framework for assessing the STB’s proposals.

On July 8, 2019, the STB decided to delay consideration of a petition asking the board to adopt a procedural rule that would require benefit-cost analysis of certain board rulemakings.⁶ On November 4, 2019, the STB solicited further information from the public about specific methods

³ Surface Transportation Board, “Market Dominance Streamlined Approach: Notice of Proposed Rulemaking,” Docket No. EP 756 (September 11, 2019). [Hereinafter referred to as “Market Dominance NPRM.”]

⁴ Surface Transportation Board, “Final Offer Rate Review: Notice of Proposed Rulemaking,” Docket Nos. EP 755 and EP 665 (Sub-No. 2) (September 11, 2019). [Hereinafter referred to as “Final Offer NPRM.”]

⁵ See Kenneth D. Boyer, Jerry Ellig, José A. Gómez-Ibáñez, Anne V. Goodchild, Richard L. Schmalensee, Wesley L. Wilson, and Frank A. Wolak, “Public Interest Comment The Surface Transportation Board’s Notices of Proposed Rulemaking: Docket No. EP 755, Final Offer Rate Review, and Docket No. EP 756, Market Dominance Streamlined Approach,” October 17, 2019. [Hereinafter referred to as “Members of the TRB Study Committee Comment.”] These individuals’ comments are based on the report they produced for the Transportation Research Board, MODERNIZING FREIGHT RAIL REGULATION, Transportation Research Board Special Report No. 318 (2015), <https://www.nap.edu/download/21759> [Hereinafter referred to as “MODERNIZING FREIGHT RAIL REGULATION.”]

⁶ Surface Transportation Board, “Association of American Railroads—Petition for Rulemaking: Decision,” Docket No. EP 752 (July 8, 2019) at 2.

that could be used for cost-benefit analysis of rules related to economic regulation of freight railroads.⁷ The board asked commenters to address a specific hypothetical rule, and I intend to do so in a comment to be submitted in Docket EP 752 at a later date.⁸ At the time the board released its request for information, I had already drafted this comment outlining how a cost-benefit framework could be applied in the Market Dominance Streamlined Approach and Final Offer Rate Review proceedings.

These two proceedings provide an excellent opportunity for the STB to “test drive” the framework for benefit-cost analysis that is most commonly employed by federal agencies: the analytical principles and requirements articulated in President Clinton’s Executive Order 12866⁹ (which has been reaffirmed by every president since) and OMB Circular A-4.¹⁰ The most common and accurate term for this type of analysis is “Regulatory Impact Analysis” (RIA), because a full RIA involves more than just estimation of benefits and costs.¹¹

This comment briefly explains the RIA framework and demonstrates how it could be used to answer key factual questions the STB must answer in order to accomplish its statutory goals. In some cases, the Notices of Proposed Rulemaking (NPRMs) or the Rate Reform Task Force Report already include some of the relevant information and analysis. Where information or analysis are missing, I hope that other parties in this proceeding will be able to supply the data and other information required to fill the gaps, thus enabling the board to conduct a more complete assessment of the need for, and consequences of, these proposed rules.

Based on the analysis presented in this comment, I recommend the following in the Market Dominance Streamlined Approach and Final Offer Rate Review proceedings:

1. The STB should conduct an RIA-style analysis that assesses the extent and cause of the problem the regulation seeks to address, identifies alternative solutions tailored to address whatever problem exists, and assesses the benefits, costs, and transfers associated with each alternative compared to the “no action” baseline. Even if constraints of time, data, or analytical capabilities do not permit every question to be investigated to the extent suggested in this comment, use of the RIA analytical framework would help ensure that the STB’s decisions are informed by evidence about the need for the regulation and the major consequences of alternatives.

⁷ Surface Transportation Board, “Association of American Railroads – Petition for a Rulemaking: Solicitation of Information,” Docket No. EP 752 (November 4, 2019) at 2.

⁸ *Id.* at 3.

⁹ Exec. Order No. 12866, 58 Fed. Reg. 51,735 (Oct. 4, 1993).

¹⁰ U.S. OFFICE OF MGMT. & BUDGET, CIRCULAR A-4, REGULATORY ANALYSIS (2003), *available at* https://obamawhitehouse.archives.gov/omb/circulars_a004_a-4/.

¹¹ This term of art appears nowhere in Executive Order 12866. It originated in President Reagan’s Exec. Order 12291, 46 Fed. Reg. 13,193 (Feb. 17, 1981), § 3. The name stuck.

2. The analysis should include consideration of the alternatives suggested by the former members of the TRB Study Committee in their comments, as these alternatives more carefully tailor the rate complaint procedure to address potential problems.

3. The STB should encourage interested parties to supply data, studies, and other information necessary to conduct this analysis in their reply comments. The STB should also consider extending the reply comment period for this purpose.

The Regulatory Impact Analysis Framework

The basic RIA framework consists of four main elements:

(1) Assess the nature and significance of the problem the agency is trying to solve, so the agency knows whether there is a problem that could be solved through regulation and, if so, whether the agency can tailor a solution that will effectively solve the problem;¹²

(2) Identify a wide variety of alternative solutions;¹³

(3) Define and estimate the benefits of each alternative;¹⁴

(4) Define and estimate the costs of each alternative,¹⁵ including cumulative costs of regulations.¹⁶

The purpose of benefit-cost analysis is to determine whether a government action can improve economic efficiency and to compare the effects of alternative government actions on economic efficiency. A benefit-cost analysis of alternatives can identify the alternative with the greatest “net benefits” (benefits minus costs), which is the most efficient alternative.¹⁷

The Staggers Act does not explicitly require benefit-cost balancing to maximize economic efficiency. It essentially requires the STB to strike a balance between the goals of ensuring that rates are reasonable when a railroad lacks effective competition, providing “fair and expeditious” decisions when regulation is required, and ensuring that carriers earn adequate revenues to provide a “safe and efficient rail transportation system.”¹⁸

¹² Exec. Order No. 12866, §§ 1(b)(1) and 6(a)(3)(B)(i).

¹³ *Id.* at § 6(a)(3)(C)(iii). *See also* U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 3-5.

¹⁴ Exec. Order No. 12866, §§ 6(a)(3)(C)(i) & 6(a)(3)(C)(iii). *See also* U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 7-9.

¹⁵ Exec. Order No. 12866, §§ 6(a)(3)(C)(ii) & 6(a)(3)(C)(iii). *See also* U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 18-42.

¹⁶ Exec. Order No. 12866, § 1(b)(11); Exec. Order No. 13563, 76 Fed. Reg. 3,821 (Jan. 21, 2011), § 1(b)(2).

¹⁷ U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 2.

¹⁸ Staggers Rail Act of 1980, Public Law 96-448, §101.

In this case, an analysis that clearly separates economic benefits and costs from transfers can help the STB more clearly identify the impacts of regulatory alternatives that are most relevant to its statutory mission. Given the importance of distributional issues in freight rail regulation, OMB Circular A-4 is worth quoting at length on this point:

Benefit and cost estimates should reflect real resource use. Transfer payments are monetary payments from one group to another that do not affect total resources available to society. A regulation that restricts the supply of a good, causing its price to rise, produces a transfer from buyers to sellers. The net reduction in the total surplus (consumer plus producer) is a real cost to society, but the transfer from buyers to sellers resulting from a higher price is not a real cost since the net reduction automatically accounts for the transfer from buyers to sellers...

You should not include transfers in the estimates of the benefits and costs of a regulation. Instead, address them in a separate discussion of the regulation's distributional effects.¹⁹

The remainder of this comment outlines how to apply the RIA framework to the proposed rules. For the sake of clarity in exposition, I lay out the steps to conduct a reasonably thorough analysis. Of course, the perfect should not be the enemy of the good; the available time, data, and analytical capabilities may not permit every question to be investigated as thoroughly as suggested below.²⁰ Use of the general RIA framework, however, would help ensure that the STB's decisions are informed by evidence about the need for the regulation and the major consequences of alternatives.

Problem Analysis

A thorough problem analysis should offer a coherent theory that identifies the cause of the problem the regulation seeks to address, along with evidence that the problem is real and significant.

Theory of the problem

A coherent theory of the problem addressed in this proceeding depends on the concatenation of two factors: railroad market power over “captive” shippers that have no good transportation alternatives, and the absence of a low-cost administrative process that would allow small captive shippers to bring and resolve rate complaints before the STB.

¹⁹ U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 38.

²⁰ As Circular A-4 notes, “There must be some balance between thoroughness and the practical limits on your analytical capacity.” U.S. OFFICE OF MGMT. & BUDGET, *supra* note 10, at 7.

Market power

A large portion of railroads' costs are joint costs of serving many shippers, rather than costs attributable to individual shippers or shipments. To cover these joint costs, railroads need to charge prices that exceed the incremental cost of individual shipments. Economically efficient prices include markups over incremental cost that vary based on shippers' elasticity of demand. Railroads face competition for most shipments, but some shippers have no good transportation alternatives to a single railroad. Because such a "captive" shipper has no good alternatives, it has a low elasticity of demand. Therefore, an economically efficient set of prices would require captive shippers to pay higher markups over incremental cost than other shippers.²¹

Federal policy recognizes the need for this type of differential pricing.²² The Staggers Act gives railroads the freedom to negotiate prices individually with shippers, which allows them to charge different shippers different prices.²³

At the same time, congressional concern for fairness led legislators to give the STB authority to examine tariffed rates for shipments for which a railroad is "market dominant" and ensure that those rates are just and reasonable.²⁴ When a railroad is market dominant, the board is expected to constrain rates if, upon complaint by a shipper, the board determines that the rate is not just and reasonable. Thus, the law's concern with equity could prompt the STB to set some rates below the economically efficient level.

Absence of a low-cost administrative process

The current proceeding arose due to the STB's concern that the cost of pursuing a rate complaint under current procedures is prohibitive for small shipments. One aspect of the shipper's cost is the out-of-pocket cost of pursuing the complaint. Another aspect of the cost for some shippers is an opportunity cost; if the shipper switches from a contract to a tariff rate in order to qualify to bring a complaint, it must pay the higher tariff rate until the complaint is resolved. Thus, the length of time the proceeding takes can directly affect the cost to the shipper.²⁵

²¹ Wesley W. Wilson and Frank A. Wolak, "Benchmark Regulation of Multiproduct Firms: An Application to the Rail Industry," National Bureau of Economic Research Working Paper No. 25268 (2018) at 1-2, <https://www.nber.org/papers/w25268>. This is an application of the general economic theory outlined by Frank Ramsey, "A Contribution to the Theory of Taxation," 37 *Economic Journal* 47 (1927).

²² Rate Reform Task Force, REPORT TO THE SURFACE TRANSPORTATION BOARD (2019) at 3. [Hereinafter referred to as "Rate Reform Task Force Report."]

²³ Id.

²⁴ Id.

²⁵ Final Offer NPRM at 3-4.

Evidence of the problem

Three types of evidence are necessary to demonstrate that these potential problems are real and significant for small shipments: (1) evidence that railroads are market dominant for a significant number of small shipments, (2) evidence that market dominant railroads may be charging unjust or unreasonable rates for these shipments, and (3) evidence that current rate complaint procedures are too costly to use for small shipments.

(1) Evidence of market dominance for small shipments

To determine whether the current rulemaking is necessary, the board should not be expected to identify comprehensively all of the small shipments for which railroads are market dominant. This is information that the market dominance proceeding is supposed to reveal in particular cases. If the board already knew these instances, there would be no need for a market dominance determination in individual cases.

However, the board should assess evidence, in addition to interested parties' assertions, that would indicate whether significant numbers of small shipments are carried under circumstances where the railroad *may* be market dominant. Using the carload waybill sample and other available data, it is possible to identify whether a shipment has feasible competitive alternatives (such as another railroad or water transport), travels a distance that makes truck transport a feasible alternative, travels at a rate below 180 percent of average variable cost, or is within the probability distribution of rates charged for similar shipments that are deemed competitive.²⁶ Shipments of various commodities that may lack competitive alternatives can be segmented by size. The results should help the board identify whether it is plausible that significant numbers of small shipments lack competitive alternatives.

(2) Evidence of potentially unjust or unreasonable rates for small shipments

To determine whether the current rulemaking is necessary, the board should not be expected to identify comprehensively all of the small shipments for which rates are not just and reasonable. This is information that the rate complaint procedure is supposed to reveal in response to a shipper's complaint. If the board already knew these instances, there would be no need for a determination in individual cases.

However, the board should assess evidence, in addition to interested parties' assertions, that shows whether market dominant railroads carry significant numbers of small shipments at rates that *may* be unjust or unreasonable. Using a rate benchmarking process like the one recommended by the Committee for a Study of Freight Rail Transportation and Regulation, the

²⁶ Wilson and Wolak, *supra* note 21, at 10, list the databases used to identify a shipment's origin, destination, and availability of competitive alternatives.

board could employ the carload waybill sample to assess whether significant numbers of small shipments carried by railroads that may be market dominant have unusually high rates given the characteristics of the shipment.²⁷

(3) Evidence that current rate complaint procedures are too costly

The primary evidence cited in the NPRM suggesting that current rate complaint procedures are cost-prohibitive is comments to that effect by shippers and shipper associations.²⁸ If these comments are merely assertions unaccompanied by evidence, the board should not take them at face value, as shippers have an obvious financial interest in arguing for lower-cost complaint procedures regardless of whether their rates are reasonable.²⁹ A better approach is the one taken by the board in *Simplified Standards*, where the board estimated, based on evidence presented in a comment by interested parties, the cost of pursuing cases under the simplified Stand-Alone Cost (SAC) method was approximately \$250,000.³⁰

To assess whether the current rate dispute mechanisms are uneconomical for small shipments, the board needs evidence of whether railroads that may be market dominant carry a significant number of shipments at rates that would make the shipper eligible for less than \$250,000 in rate relief. It is not obvious, based on information provided in the NPRM, whether the \$250,000 cost of a three-benchmark case makes this rate dispute mechanism inaccessible for a significant number of small shipments. The Advance Notice of Proposed Rulemaking for the current proceeding mentions USDA's estimate that the process should cost no more than \$50,000 in order to be accessible for agricultural shippers.³¹ Perhaps USDA's calculations provide a starting point for analysis that would provide some indication of whether significant numbers of shipments that may be eligible for rate relief are too small to make use of the existing rate complaint procedures worthwhile.

Alternatives

A thorough assessment of alternatives should consider multiple different alternatives in addition to the favored alternative and no action. Changes in different provisions of the same basic regulation can also be considered alternatives.

²⁷ See MODERNIZING FREIGHT RAIL REGULATION, and Wilson and Wolak, *supra* note 21.

²⁸ Final Offer NPRM at 3.

²⁹ As the board noted in rejecting a \$150 user fee to file a simplified SAC case, a shipper may have an incentive to file a case "simply to engage in a fishing expedition or to use as leverage in rate negotiations." Surface Transportation Board, Docket No. EP 646 (Sub. 1), Decision (Sept. 5, 2007), at 69.

³⁰ *Id.* at 93-94.

³¹ Surface Transportation Board, "Rail Transportation of Grain, Rate Regulatory Review," Docket No. EP 665 (Sub-No.1) and "Expanding Access to Rate Relief," Docket No. EP 665 (Sub.-No. 2), Advance Notice of Proposed Rulemaking (August 30, 2016) at 10.

The NPRMs present the final offer approach, combined with the streamlined assessment of market dominance, as the latest in a series of alternative attempts to implement a less costly and more timely rate relief process for small shipments. No other distinct alternative to existing procedures is presented or assessed. However, the Final Offer NPRM seeks comment on several alternative versions of the final offer process: a final offer process without the streamlined assessment of market dominance, and a final offer process with no cap on the size of rate relief.³² Both are alternatives worth considering.

Final offer process without streamlined market dominance proceeding. The streamlined assessment of market dominance was proposed out of concern that market dominance determinations have become too costly and time-consuming.³³ The proposed final offer process, however, includes deadlines³⁴ that should force parties to prioritize their arguments and evidence and prevent them from complicating the market dominance determination solely to impose costs on other parties. If a shipper believes it can demonstrate market dominance within the deadlines of the final offer approach in some manner other than the streamlined market dominant approach, it might as well have that option.³⁵

Final offer process with no cap on the size of rate relief. The report of the TRB Study Committee recommended that the board use a final offer process without restricting the size of cases.³⁶ Although a lower-cost final offer process might be more attractive to small shippers than current rate relief methods, there is no conceptual reason that it could not be used for larger shipments.³⁷ However, using the final offer process for larger shipments could have much different implications for the size of the regulation's benefits, costs, and transfers than if it is used only for small shipments. The board should assess these as described below.

Several other alternatives have been suggested by the members of the TRB Study Committee in their comment, and the effects of these alternatives should be assessed in an RIA. One is the placement of time limits on the streamlined market dominance procedure, which would reduce opportunities for delay.³⁸ The comment also suggests two additions to the list of factors to establish a *prima facie* case for market dominance. Both of these alternatives would have the effect of more carefully targeting rate relief to shippers that are genuinely captive and paying unreasonably high rates.

³² Final Offer NPRM, at 9-10 and 15-16.

³³ Market Dominance NPRM at 3.

³⁴ Final Offer NPRM at 13-14.

³⁵ Members of the TRB Study Committee Comment at 4-5.

³⁶ Modernizing Freight Rail Regulation at 211-12.

³⁷ Members of the TRB Study Committee Comment at 5.

³⁸ Members of the TRB Study Committee Comment at 3.

One proposal is to employ rate benchmarking as an additional quantitative check to identify whether a railroad may be market dominant.³⁹ Currently, the only quantitative assessment in the proposed rule is the statutorily-required assessment of whether the rate exceeds 180 percent of variable cost. Variable cost, however, is calculated using the Uniform Rail Costing System (URCS), which assumes that many costs that are not variable with respect to an individual shipment are in fact variable. The TRB Study Committee⁴⁰ and individual members of that committee⁴¹ have extensively documented the arbitrariness of URCS and some of the nonsensical results it produces, such as calculations showing that 20-30 percent of rail traffic moved at rates below 100 percent of variable cost for multiple years.⁴² URCS is mandated by statute, but the STB could implement an additional quantitative check by comparing a challenged rate to a distribution of rates for similar traffic shipped under competitive conditions. A railroad would not be considered market dominant, even if the rate exceeded 180 percent of variable cost, if the rate could be shown to be below a specified level in the distribution of competitive rates for similar shipments.

A second proposal from the former members of the TRB Study Committee is to add “absence of product and geographic competition” to the list of factors.⁴³ The STB removed consideration of product and geographic competition out of concern that these issues complicated and delayed market dominance proceedings.⁴⁴ However, this omission could come at a cost of reduced accuracy. Empirical research, for example, finds that the presence of two or more railroads near the destination is associated with lower rates.⁴⁵ In its 1998 decision eliminating consideration of product and geographic competition, the STB noted that product or geographic competition had been found to provide effective competition in certain cases.⁴⁶ The STB could control complexity and delay by placing a time limit on the market dominance determination.⁴⁷

The STB should assess the consequences of these (and other promising alternatives it may decide to consider) using the structured framework described below. The analysis should recognize that different permutations of alternatives could have significantly different interactions. For

³⁹ Id. at 4.

⁴⁰ Modernizing Freight Rail Regulation at 107-22.

⁴¹ Wesley W. Wilson and Frank A. Wolak, “Freight Rail Costing and Regulation: The Uniform Rail Costing System,” 49 *Review of Industrial Organization* 229 (2016).

⁴² Modernizing Freight Rail Regulation at 117.

⁴³ Members of the TRB Study Committee Comment at 3.

⁴⁴ Surface Transportation Board, “Market Dominance Determinations: Product and Geographic Competition: Decision,” Docket No. EP 627 (December 10, 1998).

⁴⁵ Modernizing Freight Rail Regulation at 242-55; Curtis Grimm and Clifford Winston, “Competition in the Deregulated Railroad Industry: Sources, Effects, and Policy Issues,” in Sam Peltzman and Clifford Winston (eds.), *DEREGULATION OF NETWORK INDUSTRIES: WHAT’S NEXT?* (AEI-Brookings Joint Center for Regulatory Studies, 2000) at 59.

⁴⁶ Surface Transportation Board, *supra* note 44, at 6.

⁴⁷ Members of the TRB Study Committee Comment at 3-4.

example, use of the final offer procedure without a ceiling on rate relief could have very different effects depending on whether the STB also adopts the two additional factors for establishing market dominance. Similarly, adding the absence of product or geographic competition to the list of *prima facie* factors could have very different effects depending on whether the STB places a deadline on the market dominance proceeding.

Benefits

A sound regulatory impact analysis should rigorously distinguish between social benefits and transfers between affected parties. The additional rate relief shippers could receive as a result of less costly or more timely procedures is not a social benefit; it is a transfer from railroads to shippers. The primary social benefit of new rate relief procedures would be the value of expanded output (increased shipments) that the rate relief facilitates.⁴⁸ As a matter of economic theory, one would expect this value to be small for captive shippers. Captive shippers, by definition, have a low elasticity of demand for the railroad's transportation service, which means output would not be expected to increase much in response to a rate reduction.

Consistent with economic theory, empirical analysis has found that the elasticity of demand for the categories of commodities that account for most captive shipments is relatively low.⁴⁹ Hence there would be only a small expansion of output in response to rate reductions. Employing 1998 data, Grimm and Winston estimated that captive shippers pay rates that are about 21 percent higher than rates for similar non-captive traffic, but the total "deadweight loss" (value of forgone output) associated with this rate differential is only about \$60 million annually.⁵⁰ In the absence of evidence to the contrary, both economic theory and prior empirical analysis suggest that the STB can presume the social benefits of rate relief will be small.

Despite this presumption, the STB should be open to the possibility that rate relief could lead to increased output in some cases. For individual rate cases under the proposed new procedures, a shipper filing a rate complaint should be encouraged to supply evidence about potential output expansion as part of the justification for its final offer. If the shipper's evidence is convincing, the STB could count the social benefit from expanded output as an additional reason to accept the shipper's final offer.

⁴⁸ Any reduction in administrative costs to the federal government, shippers, and railroads caused by the new procedures could be considered either a benefit or a negative cost. In this comment, administrative costs are discussed in the section on costs below.

⁴⁹ See estimates cited in Grimm and Winston, *supra* note 45, at 65.

⁵⁰ *Id.*

Costs

As is the case with benefits, the additional rate reductions railroads may have to grant shippers as a result of less costly or more timely rate complaint procedures are not social costs; they are transfers from railroads to shippers. The primary social costs associated with the proposed rate relief procedures consist of two elements: administrative costs, and any reductions in the quantity or quality of railroad output that occur due to the cumulative effect of rate reductions on railroad investment.

Administrative costs

Past STB proceedings have calculated a shipper's cost of pursuing a rate case under the proposed methodology. This is one key input into the calculation of total administrative costs. Therefore, the STB should estimate this figure for each of the alternative procedures suggested in this proceeding, such as the final offer procedure for small shipments with a streamlined market dominance procedure, the final offer procedure with no cap on rate relief and a streamlined market dominance procedure, and the final offer procedure with no cap on rate relief and the current market dominance procedure. A full accounting of administrative costs should also include the cost to railroads of responding to a rate case and the cost to the STB of processing and adjudicating the case.

To determine the total administrative cost of the new procedures, the STB also needs a credible estimate of the number of new cases likely to be filed. The Paperwork Reduction Act section of the Final Offer NPRM states that the STB receives four rate complaints per year and that the final offer procedure will lead to the filing of four additional complaints per year.⁵¹ The Paperwork Reduction Act section of the Market Dominance NPRM states that the STB receives four rate complaints per year and the simplified market dominance procedure would lead to the filing of five additional complaints per year, including the four counted in the Final Offer NPRM.⁵² No factual basis is given for the estimates of the number of new complaints. Estimates of burden hours and "non-burden costs" are given for both the existing and the new complaints, but no sources for the figures are provided. Thus, it is not clear what evidence these estimates are based on, whether the assumed number of new complaints is a reasonable quantitative estimate of the likely shipper response to the new procedures, or whether the burden hours and non-burden costs cover all of the administrative costs of a rate complaint.

The new procedures could produce a net cost saving (negative cost) if the STB expects that a sufficient number of complaints pursued under the existing, costlier procedures would in the future be pursued using the new, less costly procedures. If the primary effect of the new procedures

⁵¹ Final Offer NPRM at 27.

⁵² Market Dominance NPRM at 20.

is to increase the number of complaints, then the new procedures would likely lead to an overall increase in administrative costs.

Cumulative costs

The cumulative costs of a rate complaint procedure are the value of railroad output forgone if the new rate procedure affects railroad revenues sufficiently to reduce railroad investment. Investment, of course, is an input, and therefore investment is a cost, not a benefit. But reduced railroad investment could affect the quantity, quality, and safety of rail service. The policy experiment that demonstrates the relationship between regulation, investment, output, service quality, and safety is, of course, passage of the Staggers Act. Post-Staggers empirical studies agree that the legislation increased railroad investment, expanded railroad output, generally improved service quality, and clearly improved safety.⁵³

To assess the cumulative costs of the proposed rate complaint procedure, the key empirical question the STB must answer is whether the proposed procedure would affect railroad investment significantly enough to affect the quantity, quality or safety of rail service. The value of any reduction in quantity, quality or safety would count as a social cost of a rate complaint procedure that reduced railroad investment.

By definition, the cumulative cost associated with one or a few small rate cases is likely to be negligible, since the amount of revenue affected would be small. Cumulative costs have the potential to be large if (1) the new procedures lead to a large number of small rate cases, (2) the new procedures also increase the number of large rate cases, or (3) decisions in a few rate cases give shippers greater leverage to obtain concessions from railroads in contract negotiations, thus creating an effect on railroad revenues that is larger than the revenues at stake in the rate cases that are actually brought.

For this reason, it is critical that the STB investigate the size of the likely effect of the new procedures on railroads' revenues, assess whether that revenue impact is likely to affect investment, and assess the effect of any substantial change in investment on the quantity, quality, and safety of rail service.

Transfers

To estimate accurately the size of the transfers the new rate complaint procedures might produce, the STB would first need to know which shippers' rates are not just and reasonable and

⁵³ See Modernizing Freight Rail Regulation at 27-33; Jerry Ellig, "Railroad Deregulation and Consumer Welfare," 21 *J. Reg. Econ.* 143 (2002); C. Winston, T.M. Corsi, C. Grimm. and C.A. Evans, *THE ECONOMIC EFFECTS OF SURFACE FREIGHT DEREGULATION* (Brookings, 1990); Jerry Ellig and Patrick A. McLaughlin, "The Regulatory Determinants of Railroad Safety," 49 *Rev. Ind. Org.* 371 (2016).

then compare those rates to the rates that are likely to emerge under the new procedures. Such an estimate is, of course, not possible, since it requires information that the new rate complaint procedures are supposed to produce. In addition, the total transfers attributable to the proposed rate complaint procedures are not just the rate reductions that could occur as a result of rate complaints, but rather the total reduction in rail rates that may occur due to the existence of a new, lower-cost STB procedure. If the new procedure gives shippers more leverage in negotiations with railroads, the total transfers would likely be larger than just the amounts awarded in rate cases.

Rate benchmarking could be used to produce a range of estimates of the potential amount of revenue at stake. The problem analysis section above recommended that the STB assess the potential size of the problem using rate benchmarking to assess whether significant numbers of small shipments carried by railroads that may be market dominant have unusually high rates compared to similar shipments in markets where railroads face competition. Using the carload waybill sample data, it is possible to calculate the revenue impact on railroads when rates for captive shippers are set equal to various competitive benchmark prices.⁵⁴ The STB could estimate a range of possible transfer amounts associated with the selection of a range of competitive benchmarks. Alternatively, the STB could construct a range of possible reductions in rail rates based on the percentage reductions actually awarded in past rate cases.

Conclusion

The Staggers Act does not explicitly require benefit-cost balancing. Instead, it focuses on the tradeoff between fairness to captive shippers and the potential social costs of regulation. Nevertheless, the RIA-style analysis outlined above has the potential to answer several key questions the STB must address in order to carry out its statutory mandate in the most effective and efficient manner:

1. Does the evidence show that railroads may have market dominance over significant numbers of small rail shipments that could be affected by the proposed regulation?
2. Does the evidence show that significant numbers of small rail shipments over which railroads may have market dominance may also be paying rates that may not be just and reasonable?
3. Does the cost of current rate complaint procedures effectively preclude STB decisions on whether railroads have market dominance over those shipments and whether rates for those shipments are just and reasonable?

⁵⁴ Wilson and Wolak, *supra* note 21 at 20-32, performed this calculation for petroleum products, farm products, coal, and chemicals.

4. What alternatives to the current rate complaint process would be most precisely tailored to address whatever problem exists?

5. Could new complaint procedures create significant cumulative costs by reducing railroad investment in ways that could affect the efficiency, safety or soundness of the rail transportation system?

Based on the foregoing, I recommend the following:

1. The STB should conduct an RIA-style analysis that assesses the size and cause of the problem the regulation seeks to address, identifies alternative solutions, and assesses the benefits, costs, and transfers associated with each alternative compared to the “no action” baseline. Even if constraints of time, data, or analytical capabilities do not permit every question to be investigated to the extent suggested in this comment, use of the RIA analytical framework would help ensure that the STB’s decisions are informed by evidence about the need for the regulation and the major consequences of alternatives.

2. The analysis should include consideration of the alternatives suggested by the members of the TRB Study Committee in their comments, as these alternatives more carefully tailor the rate complaint procedure to address potential problems.

3. The STB should encourage interested parties to supply data, studies, and other information necessary to conduct this analysis in their reply comments. The STB should also consider extending the reply comment period for this purpose.