

BEFORE THE SURFACE TRANSPORTATION BOARD

248970

STB Ex Parte No. 755

FINAL OFFER RATE REVIEW

ENTERED
Office of Proceedings
November 12, 2019
Part of
Public Record

COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

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November 12, 2019

INTRODUCTION

The Association of American Railroads (“AAR”) respectfully submits these comments in response to the Notice of Proposed Rulemaking (“NPRM”), served on September 11, 2019, in which the Board proposes adopting “Final Offer Rate Review.” AAR is a trade association that represents the interests of North America’s major freight railroads, and often presents comments and testimony in Board proceedings. AAR and its freight member railroads have a strong interest in this rulemaking and in ensuring that the Board’s rate reasonableness process conforms to the law and is guided by sound economics.

The Board describes Final Offer Rate Review (“FORR”) as “a new procedure for challenging the reasonableness of railroad rates in smaller cases.” NPRM at 1. The Board historically has exercised its authority to judge the reasonableness of a challenged rate—and, if the challenged rate is found unlawful, to prescribe a maximum rate—by attempting to replicate market outcomes after a full hearing that gives due consideration to a host of statutorily-required factors. Under FORR, however, “the Board would decide a case by selecting either the complainant’s or the defendant’s final offer, subject to an expedited procedural schedule that adheres to firm deadlines.” *Id.* In short, the Board has proposed a new basis for challenging the reasonableness of a rail rate: that a complainant can propose a rate that the Board finds to be more reasonable than the one established by the carrier.

FORR conflicts with the governing statutes and is not a permissible method of resolving a rate reasonableness complaint. Congress did not give the Board authority to

adjudicate rate cases through final-offer decisionmaking, and FORR deprives railroads and shippers of their due process and statutory rights to a “full hearing,” 49 U.S.C. § 10704(a)(1), before an adjudicator that exercises its own independent judgment and has not announced in advance that it will only render decisions that have been proposed by one of the parties.

The Board identifies no other agency that sets rates in this manner. FORR is a radical departure from the economic, market-based principles that have long governed the Board’s maximum rate determinations. If adopted, it will impose massive coercive pressure on railroads, forcing them to either immediately accept liability, or to defend their charged rate and run the enormous risk that if their charged rate is deemed unreasonable, even by a dollar, the shipper will effectively set its own rate—even if that rate is a small fraction of the rate that would be set by a competitive market.

Compounding the arbitrariness is the vagueness that plagues the Board’s proposal. The Board declines to adopt a methodology for determining reasonableness or setting maximum rates, announcing that parties are free to develop and submit their own methodologies. The absence of an ascertainable standard prevents railroads from knowing in advance what the Board might consider a reasonable rate; it also prevents them from knowing, even after a rate has been challenged and litigation is underway, the standard the Board will use to decide the case. Although the Board states that under FORR, “[n]o litigation over discovery disputes would be permitted,” it threatens to draw an adverse inference against railroads that fail to produce “relevant information” in discovery. NPRM at 8. But because the parties will not know the applicable legal

standard until the Board announces its decision, it will be impossible to know during discovery what “information” would be “relevant” to the Board’s decisionmaking process. Moreover, whether a party engages in discovery misconduct is wholly irrelevant to the reasonableness of a challenged rate, and establishing a maximum lawful rate based on inferences drawn from discovery responses would be arbitrary. All of this violates due process.

The Board states that its objective in proposing Final Offer Rate Review is to provide a meaningful avenue for shippers to bring small rate challenges. NPRM at 4, 7. But the proposed rule will not confine FORR to small shippers or small disputes. Arbitrarily capping the available relief at \$4 million per case will not prevent large shippers from bringing multiple FORR cases challenging multiple lanes, aggregating their claims in a way that will result in railroads facing liability far in excess of \$4 million every other year.

For all these reasons, the Board should withdraw its notice of proposed rulemaking.

BACKGROUND

A. Statutory Authority

The Board’s statutory authority to adjudicate rate disputes requires the Board to find that the carrier has market dominance and, if so, whether the charged rate is reasonable in light of certain specified factors. “If the Board determines . . . that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable.”

49 U.S.C. § 10701(d)(1). In assessing the reasonableness of a challenged rate, the Board must “recogniz[e] the policy of this part that rail carriers shall earn adequate revenues.”

Id. § 10701(d)(2). In addition, the Board must be guided by the Rail Transportation Policy, which sets forth numerous additional goals and objectives. *Id.* § 10101. In making a reasonableness determination, the Board must also “give due consideration” to three factors: “the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic;” “the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic”; and “the carrier’s mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier’s overall revenues.” *Id.* § 10701(d)(2).

The Board has the statutory authority to “prescribe the maximum rate” following a “full hearing.” Under 49 U.S.C. § 10704(a)(1), “[w]hen the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does or will violate [Part A, Subtitle IV of Title 49], the Board may prescribe the maximum rate, classification, rule, or practice to be followed.” Congress has further provided that the Board shall establish “simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.” 49 U.S.C. § 10701(d)(3); *see also id.* § 10704(d)(1) (“The Board shall maintain procedures to ensure the expeditious handling of challenges to the reasonableness of railroad rates.”).

B. The Board's Approach To Rate Reasonableness Determinations

The Board has long applied Constrained Market Pricing (“CMP”) as a way of safeguarding the railroads’ operating efficiency and financial health, while at the same time ensuring reasonable rates for shippers on routes that lack effective competition. *See Coal Rate Guidelines – Nationwide*, 1 I.C.C.2d 520 (1985), *aff’d sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). A key element of CMP is the Stand Alone Cost (“SAC”) constraint, which aims to protect shippers from bearing costs of inefficiencies or from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of the carrier’s traffic base. *Coal Rate Guidelines*, 1 I.C.C.2d at 542-46. A SAC analysis does this by simulating the competitive rate that would exist in a market that is free from barriers to entry. *Id.* at 528.

Because a SAC analysis can be complicated, the Board has adopted simplified procedures for cases below specified thresholds. A Three-Benchmark analysis compares the challenged rate to three benchmark figures, each expressed as a relationship between revenues and variable costs; and a Simplified-SAC test focuses on whether a captive shipper is forced to cross-subsidize other parts of the railroad’s network. *See Simplified Standards for Rail Rate Cases*, EP 646 (STB served Sept. 5, 2007), *aff’d sub nom. CSX Transp., Inc. v. STB*, 568 F.3d 236, *vacated in part*, 584 F.3d 1076 (D.C. Cir. 2009). The Board subsequently increased the relief available under Three-Benchmark and eliminated the limit on Simplified-SAC at the request of shipper groups. *See Rate Regulation Reforms*, EP 715 (STB served July 18, 2013), *remanded in part sub nom. CSX Transp., Inc. v. STB*, 754 F.3d 1056 (D.C. Cir. 2014).

C. Final Offer Rate Review

The Board's Final Offer Rate Review proposal marks a dramatic departure from the Board's prior approaches. Under the proposed procedure, the Board would decide whether the complainant had demonstrated market dominance based on the expedited procedures proposed in EP 756, but the Board would not apply its established rate reasonableness tests and would not independently determine the maximum rate. Rather, the Board would simply choose either the shipper's or the carrier's final offer—a procedure best known for its use in salary arbitrations for major league baseball players.

As envisioned by the Board, a FORR case would be litigated and decided within a tightly compressed timeframe. A 21-day discovery period commences immediately upon filing of the complaint and “[n]o litigation over discovery disputes would be permitted.” NPRM at 8. Rather, “if a party unreasonably withholds information that the Board subsequently deems to be relevant, the Board would take that withholding into account in making its final decision.” *Id.* Then, “[f]ollowing discovery, parties would simultaneously submit their market dominance presentations and final offers, and each party would also submit an analysis addressing the reasonableness of the challenged rate and support for the rate in the party's offer.” *Id.* at 10.

The Board will not announce in advance the methodology it will use in deciding between the final offers. Parties are free to “choose” their own preferred methodology to support their offer: they may use “revised versions of the Board's existing rate review methodologies or new methodologies altogether.” NPRM at 10, 11. Based on the parties' submissions, “[i]f the Board finds that the complainant's market dominance

presentation and rate reasonableness analysis demonstrate that the defendant carrier has market dominance over the transportation to which the rate applies and that the challenged rate is unreasonable, the Board would then choose between the parties' final offers." *Id.* at 13. "The Board's criteria for determining rate reasonableness of and choosing between the offers would be based on its consideration of the rail transportation policy in 49 U.S.C. § 10101, the Long-Cannon factors in 49 U.S.C. § 10701(d)(2), and appropriate economic principles." NPRM at 10.

The Board's stated objective is to remove what it perceives as a barrier to shippers bringing smaller cases before the Board. "By lowering the costs of litigating smaller rate cases, the Board expects that complainants with smaller rate cases, who otherwise might have been deterred from challenging a rate due to the cost of bringing a case under the Board's existing rate reasonableness methodologies, would have a more accessible avenue for rate reasonableness review by the Board." NPRM at 7.

DISCUSSION

I. The Board Lacks Statutory Authority To Adopt Final Offer Rate Review.

The Board's proposed final-offer procedure is not authorized by, and in fact conflicts with, the statute giving the Board the power to adjudicate reasonableness and prescribe maximum rates. That statute provides:

When the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does or will violate [Part A, Subtitle IV of Title 49], the Board may prescribe the maximum rate, classification, rule, or practice to be followed.

49 U.S.C. § 10704(a)(1). Part A in turn provides that if a rail carrier has market dominance, its charged rate must be “reasonable” in light of certain specified factors and considerations. *Id.* § 10701(d)(1)-(d)(2); *id.* § 10101.

A. Congress Has Not Authorized The Board To Adjudicate Rate Disputes Through A Final-Offer Process.

1. “It is axiomatic that an administrative agency’s power to promulgate legislative regulations is limited to the authority delegated by Congress.” *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988). The Board, like all federal agencies, “has no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress.” *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001). That is why, “for *Chevron* deference to apply, the agency must have received congressional authority to determine the particular matter at issue in the particular manner adopted.” *City of Arlington v. FCC*, 133 S. Ct. 1863, 1874 (2013).

Although Congress has given the Board rate-setting authority in certain circumstances, it has *not* given the Board the authority “to determine the particular matter at issue in the particular manner adopted,” *City of Arlington*, 133 S. Ct. at 1874—that is, to determine the maximum reasonable rate through a baseball-style final offer process. Final-offer decisionmaking is an *arbitration* technique that arbitrators use to force settlements, as the Board’s own authorities make clear. See Michael Carrell and Richard Bales, *Considering Final Offer Arbitration to Resolve Public Sector Impasses in Times of Concession Bargaining*, 28 Ohio St. J. on Disp. Resol. 1, 1 (2012) (final offer arbitration is “an ADR method that guarantees a settlement”); Josh Chetwynd, *Play Ball? An*

Analysis of Final-Offer Arbitration, Its Use in Major League Baseball and Its Potential Applicability to European Football Wage and Transfer Disputes, 20 Marq. Sports L. Rev. 109, 109 (2009) (describing final-offer decisionmaking as a “form of arbitration” that “spurs negotiated settlement at a very high rate”). Even the TRB report proposes final-offer decisionmaking as part of an “arbitration procedure”—not something the Board would adopt for its own use. See Nat’l Acad. Of Sciences, Eng’g. & Med., *Modernizing Freight Rail Regulation* at 211-12 (2015).

Nothing in the governing statutes, or in the Administrative Procedure Act, authorizes the Board to adopt an adjudicatory method that so drastically departs from the way agency adjudications and rate-setting proceedings have historically been conducted. The Board has publicly stated many times that it lacks the legal authority to impose arbitration without statutory authority from Congress, *see, e.g.*, NPRM at 5; *Arbitration—Various Matters Relating to its Use as an Effective Means of Resolving Disputes that are Subject to the Board’s Jurisdiction*, EP 586, slip op. at 3 n.7 (STB served Sept. 20, 2001), and the Board fails to identify any other agency that uses Final Offer Rate Review outside the arbitral context.

Although the Board claims that it “uses a final offer procedure as part of the Three-Benchmark methodology,” NPRM at 4, in Three Benchmark, the final offer procedure is a small component of the overall methodology; it does not provide the very framework for decision. Likewise, the Board’s reliance on the Canadian process for resolving rate disputes through final-offer arbitration is misplaced. NPRM at 6 & n.11. Not only are there fundamental differences between the U.S. and Canadian legal systems

that prevent importing a Canadian-style approach here, but Canada has enacted a statute authorizing final-offer arbitration. Congress, of course, has not enacted a similar statute. And whereas the Board notes that through the AAR car-hire rules, car owners and users can utilize final-offer arbitration in the negotiated car-hire rate process, NPRM at 5, that is a mechanism for two private parties to reach a negotiated car-hire rate *outside of* the regulatory system, if they are unable to negotiate the rate. In that context, the parties have agreed to be bound by the arbitrators' decision. That is very different than an agency exercising its adjudicative power by forcing this process on unwilling litigants.

Final-offer decisionmaking is an alternative dispute resolution technique that is at odds with the way judges and agency adjudicators decide cases. The task of a judge or administrative adjudicator is to decide the correct outcome as required under the governing law; it is not to decide which party has proposed a result that comes closest to the correct outcome. Final-offer decisionmaking recognizes that the outcome may not be the legally-correct outcome, but because the parties typically have consented to an arbitrator using this methodology as an alternative way of resolving their dispute, the inaccuracy is tolerated. Here, of course, where the parties have *not* consented to this procedure, the Board has no right to abandon its statutory duty to apply the law in determining, based on its own best judgment, the maximum reasonable rate.

The Board has noted that Congress tasked the Board with developing expedited procedures for deciding rate cases. But Congress was quite clear that the Board must look to procedures used by courts, not arbitrators. The STB Reauthorization Act provides:

(c) PROCEDURES.—Not later than 180 days after the date of the enactment of this Act, the Surface Transportation Board shall initiate a proceeding to assess procedures that are available to parties in litigation before courts to expedite such litigation and the potential application of any such procedures to rate cases.

Surface Transportation Board Reauthorization Act of 2015, § 11(c) (emphasis added).

Because final-offer techniques are *not* used in “litigation before courts,” they are not a permissible way for the Board to adjudicate rate disputes.

2. Final-offer decisionmaking is particularly ill-suited in this setting.

Congress has directed the Board to take a variety of considerations into account when evaluating reasonableness and prescribing rates. Most notably, Section 10704(a)(2) requires the Board to make “an adequate and continuing effort” to ensure adequate revenues while judging the reasonableness of rates. The Board must also give “due consideration” to “the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic;” “the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic”; and “the carrier’s mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier’s overall revenues.” *Id.* § 10701(d)(2). The Board’s rate determinations must also take into account the many objectives reflected in the nation’s Rail Transportation Policy, including that rail carriers “earn adequate revenues.” *Id.* § 10101(3).

The Board and the ICC have correctly concluded that the core regulatory principle that emerges from these statutory provisions is that a railroad must be able to engage in demand-based differential pricing to have the opportunity to earn adequate revenues. *Coal Rate Guidelines*, 1 I.C.C.2d 520, 525 (1985). CMP, as adopted by the Board, meets this goal by constraining the ability of railroads to price their services while taking into account market demand. *Id.*; see also *Major Issues in Rail Rate Cases*, EP 657 (Sub.-No. 1) (STB served Oct. 30, 2006).

The Board cannot give “due consideration” to all of the above factors if it is limited to two outcomes chosen by the parties. The variety of considerations Congress directed the Board to take into account when setting a maximum rate require the Board to try to achieve a reasonable precision in independently choosing the rate itself, rather than simply selecting whichever one of the parties’ proposals happens to be closer to what in the Board’s view is the actual maximum. Congress wanted the Board to exercise its independent judgment in determining the maximum reasonable rate, not to adopt whichever of the competing proposals from the parties it deems *more* reasonable. In some cases, the maximum reasonable rate—that is, the rate that best achieves the many objectives the Board is statutorily required to consider—may be above (or below) the parties’ final offers. In other cases, the maximum reasonable rate may fall between the final offers. See *Burlington Northern R. Co. v. ICC*, 985 F.2d 589, 599 (D.C. Cir. 1993) (“Of course no adjudicator would expect to be able to rely entirely on one side’s analysis.”).

The court rejected an agency's attempt to use final-offer decisionmaking in *Stone v. U.S. Forest Service*, 2004 WL 1631321 (D. Ore. July 16, 2004), concluding that the agency lacked statutory authorization to adopt the procedure. In that case, the statute at issue required the Forest Service to make a fair market valuation of land in a protected area. The agency obtained two appraisals (one arranged by the property owner, the other by the agency) and adopted "a 'baseball-arbitration'-style procedure, in which the decisionmaker simply chooses between the two [valuations], even though the actual fair market value may be somewhere in between those two values." *Id.* at *3. The court stated:

I find nothing in the applicable statutes that condones the procedures utilized by the agency here The agency ostensibly sought to calculate the fair market value of Plaintiffs' property. "Baseball-style arbitration" is not a procedure well-tailored to that end. The [statute] does not command the agency to select the "better" of the two appraisals. Perhaps neither appraisal is on the mark, and fair market value is somewhere in between.

Id. at *7.

The same logic applies here. There is nothing in the applicable statutes that condones Final Offer Rate Review, which is not a procedure well-tailored to determining the maximum rate a railroad may charge. And even if final-offer procedures were an acceptable method of retrospective dispute resolution, there is no basis for using them with regard to the Board's "legislative function" of setting rates prospectively. See *Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co.*, 284 U.S. 370 (1932) (unlike backward-looking awards of reparations, prescribing a maximum rate is legislative and forward-looking).

By adopting Final Offer Rate Review, the Board would be rejecting its historic commitment to ensuring that maximum rates reflect those that would result from a competitive market outcome. SAC is an estimation of a competitive market outcome, and Three Benchmark, while less of a market-based approach, nonetheless remains tethered to CMP. See *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1), slip op. at 73 (STB served Sept. 5, 2007). Final Offer Rate Review, in contrast to these methodologies, will produce results that are totally divorced from market-driven outcomes and principles. Rates will instead be set based on the parties' litigating positions, which themselves will be guided by speculation as to the methodology the Board might use in resolving a particular dispute. Although the Board envisions FORR as a way for individual shippers to litigate smaller disputes, shippers overall will not benefit from a process that will create results that are divorced from market outcomes. To the contrary, FORR is a blunt instrument that will *disrupt* competitive markets by setting rates for particular lanes through an arbitrary process driven by the parties' litigation strategies.

The rate-reasonableness methodologies the Board has historically used have been fine-tuned through the notice-and-comment process, and often through review by the federal courts. For example, the D.C. Circuit vacated a portion of the Simplified-SAC rule to allow the Board to more fully explain its reasoning. See *CSX Transp., Inc. v. STB*, 584 F.3d 1076 (D.C. Cir. 2009). In light of the extensive agency and judicial consideration that has been given to crafting these existing methodologies, it is arbitrary to now allow parties to modify these methodologies in whatever ways they prefer—by,

for example, simply truncating a portion of the test that does not support their desired outcome.

Even if the governing statutes authorized the Board to adopt Final Offer Rate Review—which they plainly do not—the APA requires agencies to provide a reasoned explanation when they are proposing to deviate from historic agency practice, *see Mfrs. Ry. Co. v. STB*, 676 F.3d 1094 (D.C. Cir. 2012) (vacating STB decision for failing to explain departure from precedent), and here the Board has failed to adequately explain or justify why it is deviating from CMP and jettisoning the basic economic principles that have long guided the Board in judging the reasonableness of rates.

B. Final Offer Rate Review Conflicts With The Governing Statutes.

The Board’s proposal not only lacks congressional authorization, it conflicts with the governing statutes in many respects.

First, Final Offer Rate Review does not give parties the “full hearing” the statute and due process require. *See* 49 U.S.C. § 10704(a)(1) (Board may prescribe maximum rates only after a “full hearing”). A full hearing requires an adjudicator who has retained his full decisionmaking powers, not one who has tied his hands by artificially limiting his decisional range to two possibilities. As the Supreme Court has explained, “Congress, in requiring a ‘full hearing,’ had regard to judicial standards—not in any technical sense but with respect to those fundamental requirements of fairness which are of the essence of due process in a proceeding of a judicial nature.” *Morgan v. United States*, 304 U.S. 1, 12 (1938). It would be an egregious violation of “judicial standards,” *id.*, for a judge, before he even received a complaint, to publicly announce that to streamline proceedings

in his courtroom, he would decide all cases through baseball-style arbitration decisionmaking, limiting himself to issuing orders that were proposed by whichever party came closest to what he deemed the legally correct outcome. Just as a judge or agency adjudicator cannot adopt a decisional methodology that rejects fundamental elements of a trial or adjudication—*e.g.*, refusing to assess credibility by announcing in advance that all witness testimony will be deemed credible—the Board cannot announce in advance that it will confine its decisional outcomes to the parties’ two proposals.

Second, the Board’s approach violates the Administrative Procedure Act’s mandate that the shipper—as the party seeking a rate-setting order—bears the burden of proof. Under 5 U.S.C. § 556(d), “the proponent of a rule or order has the burden of proof”—language that, as the Board concedes, puts the burden on shippers. *See* NPRM at 12-13 (“In a rate complaint proceeding, the complainant is the proponent of an order and therefore bears the burden.”). Yet under Final Offer Rate Review, the shipper is effectively relieved of its burden to prove that the challenged rate is unreasonable. That is because, as the Board acknowledges, “[s]ince the parties’ final offers should reflect what they each consider to be the maximum reasonable rate, a party’s analysis regarding the reasonableness of the challenged rate would likely overlap with its support for its final offer.” *Id.* at 12 n.24. Thus, when it comes to assessing the reasonableness of the challenged rate, the shipper need not prove anything, as reasonableness (or not) will be determined when the Board simply chooses between the two offers.

Third, the Board’s approach will render it statutorily incapable of prescribing a maximum rate in the situation where the shipper’s offer is impermissibly low (*i.e.*, when

it falls below the level at which the carrier would recover 180% of its variable costs of providing the service), and the carrier's offer is impermissibly high (*i.e.*, when it is deemed unreasonable). In that scenario, the Board would be unable lawfully to prescribe *either* of the offers as the maximum rate. This is yet another way in which the Board's decision to artificially limit itself to the binary choice supplied by the parties conflicts with its statutory mandate to reach its own independent judgment in setting the maximum reasonable rate.

II. Final Offer Rate Review Is Arbitrary And Capricious.

The NPRM states that the Board will decide FORR cases based on a standard that it will not disclose in advance, but may disclose when it announces its decision. The Board asserts that FORR will “allow for the parties to submit final offers using their preferred methodologies, including revised versions of the Board's existing rate review methodologies or new methodologies altogether.” NPRM at 11. In the Board's view, this will “allow for innovation with respect to rate review methodologies” and lead to the “creation of precedent through an adversarial process” that “creates incentives for methodological improvements over time.” *Id.* at 11-12. This is a standardless standard that is the very definition of arbitrary and capricious agency action, and renders FORR unconstitutionally vague.

Under the Board's approach, parties will not know in advance how to conform their conduct to the demands of the law. A regulation must inform “regulated parties . . . what is required of them so they may act accordingly.” *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012). Here, however, in determining the rate to charge a

shipper, a railroad cannot know in advance what the Board might deem unreasonable, because it does not know how the Board will determine “reasonableness” (actually, “most reasonable-ness”) in any given case. It may use any one of its existing methodologies, or it may use a brand new methodology developed by the shipper for use in the particular dispute. Indeed, if the Board is correct that shippers view existing methodologies as too expensive and cumbersome for resolving smaller disputes, then it is virtually certain that a shipper invoking FORR will develop its own methodology and urge the Board to adopt it. The Board may view all of this uncertainty as itself facilitating compromise, but it is mistaken: parties who cannot reliably assess risk and predict likely outcomes are ill-equipped to reach a negotiated resolution. In any event, the Due Process Clause does not permit the Board “to classify arbitrariness as a virtue.” *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 59 (1991) (O’Connor, J., dissenting).

Moreover, once a complaint proceeding has begun, railroads will not know what evidence the Board might deem relevant until it is too late. See NPRM at 8 (“[I]f a party unreasonably withholds information that the Board subsequently deems to be relevant, the Board would take that withholding into account in making its final decision,” and may draw “adverse inferences.”) Indeed, given that the Board will not disclose in advance the methodology it will use to decide the case, there is no way railroads could know with certainty the evidence the Board might ultimately deem relevant in making a rate determination. Railroads will be put to the untenable choice of producing vast amounts of confidential information out of an abundance of caution, or running the risk

that the Board will later deem some of that information to be relevant and draw an adverse inference against the railroad.

The vagueness that permeates the Board's scheme also raises the "dangers of arbitrary and discriminatory application." *Grayned v. City of Rockford*, 408 U.S. 104, 108-09 (1972). A regulation must be capable of sufficiently predictable application "so that those enforcing the law do not act in an arbitrary or discriminatory way," *Fox Television*, 567 U.S. at 253, and the Board's refusal to commit to a decisionmaking methodology falls far short of this standard. See *Paralyzed Veterans of Am. v. D.C. Arena, L.P.*, 117 F.3d 579, 584 (D.C. Cir. 1997) (noting that "[i]t is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations'"). Even more troubling, it remains unclear whether the Board will even disclose *when deciding the case* the methodology it used to choose the winner. See Comments of Kenneth Boyer et al. at 5 (Oct. 17, 2019) ("[T]he nature of final offer arbitration, along with the number of relevant considerations specified in the proposed rule, would seem to enable the STB fully to discharge its obligations without going into detail on the reasons it chose one offer rather than the other.").

In fact, it was the lack of transparency that led Intervistas to reject final-offer decisionmaking as an alternative way for the Board to decide rate disputes. Notably, the NPRM utterly ignores the Intervistas report, which specifically considered and rejected the Canadian approach as providing "no guidance for alternatives" to Stand Alone Cost. Intervistas concluded:

It is our opinion that the non-transparent final offer arbitration process used in Canada to constrain undue exercise of any market power by railways provides no guidance for alternatives to SAC. It may be that the methodologies put forward by one party or the other in the arbitrations could provide insight, but as the process is confidential, no guidance can be provided.

Intervistas, *An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification*, at 76 (2016). The Board gives no explanation as to why it believes Intervistas reached the wrong conclusion.

The Board is mistaken in believing that the FORR process will, over time, lead to the “creation of precedent” that will guide parties in future disputes. NPRM at 11. Indeed, as the primary virtue of final offer arbitration is that it forces settlements rather than litigated resolutions, if FORR operates as intended no meaningful body of precedent will develop. Even if the Board explains its reasoning in deciding a case, it will likely consist of a holistic, totality-of-the-circumstances assessment that one party’s final offer comes closest to fulfilling what the Board vaguely describes as its “guiding criteria,” including the statutorily-mandated considerations, “appropriate economic principles,” and “the agency’s expertise and general principles developed in its rate case precedent over decades.” *Id.* The Board’s standardless, ad hoc approach will provide little if any guidance to future litigants, even if it serves to insulate the Board’s decisions from appellate scrutiny by the federal courts—a problem that in itself raises serious due process concerns.

Because the rule of law requires clear legal standards that are known in advance—rather than standards that are developed ad hoc and revealed only when the decision is

announced—FORR is arbitrary and capricious under the APA, as well as unconstitutionally vague under the Due Process Clause.

III. Final Offer Rate Review Is Fundamentally Unfair And Will Unduly Pressure Railroads To Reduce Reasonable Rates.

Final Offer Rate Review will put railroads in an unfair and untenable position. Railroads will be forced to either (1) admit that their charged rate is unreasonable by submitting a lower “final offer,” or (2) resist and run the risk that if the charged rate is found unreasonable, the shipper sets its own price for both past and future transactions. The first option would lead to an immediate and potentially significant loss; the second option would in many cases present an enormous risk, especially if the shipper’s offer is substantially below the charged rate. When the deck is stacked this way, railroads will be pressured to surrender their constitutional and statutory rights to defend their charged rate. Indeed, it is precisely the coercive nature of final-offer arbitration that causes its proponents to boast that it “guarantees a settlement.” Carrell and Bales, *supra*, at 1. Shippers are not faced with the same choice—the risks are not reciprocal—and the shipper will not face the same coercive pressure because it never risks paying a rate higher than the challenged rate.

Consider a case where the shipper makes a final offer of \$25 and the railroad makes a final offer of \$100. Even if the Board were to determine that anything up to \$99 is a reasonable rate, the Board would have no choice but to accept the shipper’s final offer because the statute prohibits the Board from prescribing a rate that is unreasonable. The shipper would obtain a windfall, and the railroad would be forced to pay reparations

and provide service for the next two years at a rate far below what the Board recognizes would be reasonable.

Or consider a case where the railroad's charged rate is below the maximum reasonable rate. In this scenario, the shipper makes a final offer of \$25; the charged rate is \$75; and the maximum reasonable rate is \$100. The railroad likely would be hesitant to propose a final offer above its charged rate, as the Board may presume (erroneously) that the railroad is already charging the maximum reasonable rate. But by defending its charged rate and making a final offer of \$75, the railroad will be conceding its legal right to charge the maximum reasonable rate.

The Board's proposed approach differs in a fundamental respect from the way final-offer techniques are used in arbitration. Final-offer arbitration contemplates a back-and-forth process of negotiation that narrows the dispute before the final offers are presented to the arbitrator. Thus, the term "final" offer. Here, in contrast, the parties must submit their final offers only 35 days after the complaint is filed; there is no negotiation and thus no narrowing of the spread between offers. A central tenet of final offer arbitration is that the process forces the parties' positions to converge towards a reasonable compromise; that will not happen here. Indeed, the FORR proposal even dispenses with the mandatory mediation period that is included in all other rate complaint procedures. This heightens the risk to the railroads and makes it even less likely they would be willing to roll the dice and defend themselves, rather than immediately accept liability and settle. Such non-market rates then become the basis for the comparison

groups used in Three-Benchmark analyses, further driving railroad pricing down and away from market outcomes.

Compounding the pressure on railroads to abandon their defense and settle is the expedited schedule for FORR proceedings. The Board proposes giving railroads a mere 35 days to review the complaint, analyze the shipper's proposed methodology, conduct discovery, develop their own methodology if necessary, prepare a market dominance presentation, conduct a rate reasonableness analysis, and formulate and submit a final offer. This is grossly inadequate. Complainants will have as much time as they wish to study the lane they will target, develop a methodology, and assemble their evidence. Railroads, in contrast, will not be given sufficient time to prepare a meaningful defense, as due process and fundamental fairness require.

IV. Final Offer Rate Review Is Not Confined To Small Cases.

The Board claims that its goal is to provide an efficient way to litigate "smaller cases." NPRM at 1. But the scheme as proposed by the Board does not in fact limit Final Offer Rate Review to smaller cases. There is no restriction on the type of shippers that are eligible to file a FORR complaint. Unlike the Board's proposal in EP 665, which provided for eligibility screening through a comparison group approach, FORR is available for any and all rate challenges.

The proposed \$4 million cap on relief does not solve the problem. See NPRM at 15-16. A \$4 million dispute is not a small case, and the amount of the cap is arbitrary in any event. In the past, the Board has pegged limits on relief to the cost of the next-more-complicated method to bring a case. Moreover, the cap will not confine FORR to small

cases absent an express limit on a shipper's ability to challenge multiple lanes. Because there is no limit to aggregation of cases, a large chemical company could file 100 simultaneous FORR complaints for the same rate for the transportation of the same commodity for 100 different origin and destination pairs and potentially win \$4 million for each complaint.

The Board's stated motivation—that shippers do not have a meaningful avenue for obtaining relief (NPRM at 3)—is not supported by substantial evidence. The fact that, in the Board's view, too few rate complaints are filed does not prove the inadequacy of existing mechanisms. The purported scarcity of rate complaints could easily be explained by the fact that many rates are governed by contract, and those that are based on tariffs are generally reasonable. The Board should not embark on a drastic change of course—fundamentally changing the way it adjudicates rate disputes—without evidence that the problem it aims to solve actually exists.

V. Final Offer Rate Review Is Flawed In Many Other Ways.

In addition to the many defects discussed above, the Board's proposal suffers from a host of infirmities.

First, the Board did not adequately address how its proposal will affect the Board's statutory mandate to ensure revenue adequacy. *See* 49 U.S.C. §§ 10101(3), 10704(a)(2). That is “an important aspect of the problem,” *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), yet the notice of proposed rulemaking largely sidesteps it. The Board asserts in a single conclusory sentence that “[a]s with the Board's other rate reasonableness procedures, the agency would consider

the defendant railroad’s need for differential pricing to permit it to collect adequate revenues.” NPRM at 11. The Board fails to recognize, let alone address, how its adoption of FORR will affect revenue adequacy generally—*i.e.*, outside the context of an individual dispute—by creating a coercive downward force on rates. Even within an individual case, given that the Board is compelled to choose between two proposed rates, it is far from clear how the railroad’s need for adequate revenues could be taken into account once the Board concludes the railroad’s proposed rate is “less reasonable” than the shipper’s.

Second, the Board failed to conduct a cost/benefit analysis of its proposed rule. Executive Order 12866, entitled “Regulatory Planning and Review,” calls on agencies to make “a reasoned determination that the benefits of the intended regulation justify its costs.” Similarly, the Department of Transportation recently issued its “Policies and Procedures for Rulemakings,” which sets forth agency best practices. It states that “[r]ulemaking shall include . . . [a]n assessment of the potential costs and benefits of the regulatory action . . . or a reasoned determination that the expected impact is so minimal or the safety need so significant and urgent that a formal analysis of costs and benefits is not warranted.” *Policies and Procedures for Rulemakings*, at 11 (Dec. 20, 2018). Moreover, unless the rulemaking is mandated by statute, the agency must provide in the NPRM “a reasoned determination that the benefits outweigh the costs.” *Id.* at 13; *see also Michigan v. EPA*, 135 S. Ct. 2699 (2015) (agency acted unreasonably by declining to consider the costs of regulation). The Board has made no such determination here.

Third, the NPRM omits many other elements that the Department of Transportation has noted should be included in rulemakings. For example, it does not contain a “statement of whether a rule is required by statute.” *Policies and Procedures for Rulemakings*, at 13. It does not include a “statement of whether existing rules have created or contributed to the problem the [agency] seeks to address with the proposed rule, and, if so, whether or not the [agency] proposes to amend or rescind any such rules and why.” *Id.* And the Board does not appear to have “place[d] in the docket for the proposed rule . . . all material information relied upon by the [agency] in considering the proposed rule.” *Id.* at 14. Even though the Board, as an independent agency, is not bound by these Department of Transportation policies, they represent what the Department views as best practices and should be followed here.

Fourth, the Board does not yet appear to have complied with its duties under the April 14, 2019 Office of Management and Budget memorandum, *Guidance on Compliance with the Congressional Review Act*. That memorandum, which applies to “all Federal agencies, including the historically independent agencies,” requires the Board to submit to the Office of Information and Regulatory Affairs (“OIRA”) an analysis of whether the rule is “major” within the meaning of the Congressional Review Act, or to implement a specified process to enable OIRA to make that determination itself. *See* Memorandum at 4-5. Moreover, “[f]or all rules, agencies should include a [Congressional Review Act] compliance statement in the body of the rule to provide transparency and notice to Congress.” *Id.* at 6.

CONCLUSION

Final Offer Rate Review is arbitrary, capricious, and contrary to law. The Board should withdraw the NPRM.

Respectfully submitted,

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