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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Docket No. EP 755

FINAL OFFER RATE REVIEW

COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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Union Pacific Railroad Company submits these comments in response to the Surface Transportation Board’s Notice proposing a new procedure for challenging the reasonableness of rail rates in small cases called “final offer rate review” (“FORR”). *See Final Offer Rate Review*, EP 755 (STB served Sept. 12, 2019) (“NPRM”).

I. INTRODUCTION

FORR would mark a giant leap backward for sound rail rate regulation in the United States. By adopting FORR, the Board would abandon reliance on well understood constrained market pricing (“CMP”) principles that it has long used to judge the reasonableness of freight rail rates and, thereby, to advance the public interest. In 1985, the ICC adopted CMP as an economically sound set of principles for judging the reasonableness of rates. *See Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff’d sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). In 2007, the Board adopted the Three Benchmark test as a simplified approach for smaller rate disputes. *See Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007), *aff’d sub nom. CSX Transp., Inc. v. STB*, 568 F.3d 236 (D.C. Cir.), *vacated in part on reh’g*, 584 F.3d 1076 (D.C. Cir. 2009). Although the Three Benchmark test incorporates CMP principles, the Board has acknowledged the test is “crude” and “very rough and imprecise.” *Id.*, slip op. at 73. Indeed, the Board’s own consultants have

concluded that “[a]ny additional simplification” of the Three Benchmark test would “deviate further from the[] characteristics of CMP and would compromise the nature of the test and its adherence to the CMP principles.” InterVISTAS Consulting, Inc., *An Examination of the STB’s Approach to Freight Rail Rate Regulation and Options for Simplification*, at 129 (Sept. 14, 2016). If the Three Benchmark test only barely adheres to CMP principles, then FORR – which is designed to allow the Board to adopt new, untested rate review methods on an expedited basis – signals the Board’s intent to depart entirely from CMP principles. In other words, the Board apparently plans to invoke its “expertise” and “general principles,” NPRM at 11, to evaluate rate reasonableness based on methodologies unlikely to measure up to the rigors of CMP.

FORR would also be a giant leap backwards in another respect: it leaves parties with no meaningful guidance as to how the Board will resolve their disputes. In 1996, before it adopted the Three Benchmark test, the Board adopted guidelines for small rate cases that incorporated the same benchmarks used in the current test but did not specify how it would use them in practice. *See Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004 (1996), *pet. to reopen denied*, 2 S.T.B. 619 (1997), *pet. for review dismissed sub nom. Ass’n of Am. R.Rs. v. STB*, 146 F.3d 942 (D.C. Cir. 1998). A decade passed, and only two shippers filed complaints – a result the Board attributed to the vagueness and uncertainties surrounding the guidelines. *Simplified Standards*, slip op. at 4. In the NPRM, however, the Board provides even less guidance than it did in 1996. The Board says its criteria for determining rate reasonableness will be based on consideration of the statutory rail transportation policy, the statutory Long-Cannon factors, and “appropriate economic principles.” NPRM at 10. It also says it will apply “the agency’s expertise and general principles developed in its rate case precedent over decades.” *Id.* at 11. But these nebulous statements provide no meaningful guidance: the Board’s “expertise” and “general

principles developed in its rate case precedent” since 1985 are based on the CMP principles the Board is abandoning in its FORR proposal.

Union Pacific’s comments address FORR’s specific substantive and procedural flaws. In Part II, we show FORR’s constraints on the Board’s discretion would violate the agency’s duties assigned by Congress. The Board’s proposal to make itself a prisoner of the parties’ submissions is inconsistent with its mandated role as a guardian of the public interest. In Part III, we show the Board’s application of FORR would violate its duties to determine whether challenged rates are reasonable under standards established by Congress, and, if not, to prescribe the maximum reasonable rates the railroad may establish. In Part IV, we discuss key, unaddressed conceptual flaws in the Board’s proposal that would prevent the FORR approach from operating as described in the NPRM. In Part V, we demonstrate the Board’s stated justifications for the FORR proposal are inconsistent with the predictable consequences of the proposal’s adoption. In Part VI, we establish the FORR proposal violates due process and the use of a \$4 million rate cap – a foundational aspect of the program – would be arbitrary and capricious.

II. FORR WOULD PREVENT THE BOARD FROM FULFILLING ITS CONGRESSIONALLY DELEGATED DUTIES.

“Congress has expressly delegated to the Board responsibility for determining whether a railroad has market dominance and, if so, whether its rate is reasonable.” *Burlington N. R.R. v. STB*, 114 F.3d 206, 210 (D.C. Cir. 1997). Thus, when the Board “exercises that authority,” its decisions are “entitled to particular deference.” *Id.* By adopting FORR, however, the Board would be unlawfully constraining the exercise of its congressionally delegated authority. Although the Board acknowledges this self-imposed constraint (*see* NPRM at 17), this acknowledgement fails to consider the full scope of the Board’s action. The Board would not

merely be changing its own policies by adopting FORR, it would be abandoning its duty to exercise its expertise in the public interest.

The Board's responsibility under the Interstate Commerce Commission Termination Act ("ICCTA") is not simply to resolve discrete disputes between parties. Rather, ICCTA requires the Board to implement statutory policies with broad implications for public welfare. If rates are set too high, shippers will not supply enough goods to satisfy demand. If rates are set too low, railroads will be subsidizing inefficient production and consumption. Therefore, in judging rate cases, the Board's role is not "simply to act as an umpire, calling balls and strikes for the adversaries appearing before [the agency]." *Pub. Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & Santa Fe Ry.*, NOR 42057, slip op. at 3 (STB served Jan. 19, 2005), *pet. for review denied sub nom. BNSF Ry. v. STB*, 453 F.3d 473 (D.C. Cir. 2006). The Board must be "directly and immediately concerned with the outcome of virtually all proceedings conducted before it." *Id.* (quoting H.R. Doc. No. 678, Practices and Procedures of Governmental Control of Transportation, 78th Cong., 2d Sess., at 53 (1944)). The Board is "not intended to be a passive arbiter but the 'guardian of the public interest,' with a duty to see that this interest is at all times effectively protected." *Id.* at 4 (quoting H.R. Doc No. 678, at 53). Thus, the Board cannot be "the prisoner of the parties' submissions, but rather ha[s] the duty to 'weigh alternatives and make its choice according to its judgment of how best to achieve and advance the goals of the National Transportation Policy.'" *Id.* (quoting *Balt. & Ohio R.R. v. United States*, 386 U.S. 372, 429 (1967) (Brennan, J., concurring)). Stated differently, the Board's role in judging rate cases is not merely to resolve disputes between the parties; rather, "the right of the public must receive active and affirmative protection." *Id.* (quoting *Harlem Valley Transp. Ass'n v. Stafford*, 500 F.2d 328, 335 (2d Cir. 1974)).

FORR would transform the Board from the guardian of the public interest to a prisoner of the parties' submissions. The ICC carefully considered Congress's rail transportation policies and applied its experience and expertise to develop CMP, "the most sophisticated and accurate method available" for evaluating the reasonableness of rail rates. *Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub-No. 2), slip op. at 1 (ICC served Dec. 1, 1995); *see also Burlington N. R.R. v. ICC*, 985 F.2d 589, 596 (D.C. Cir. 1993) (CMP is "the preferred and most accurate procedure available for determining the reasonableness of rates" (internal quotation marks omitted)). When Congress later instructed the Board to develop a simplified and expedited method for small rate cases, the agency developed the Three Benchmark methodology – a streamlined test that still reflects CMP principles. *See Simplified Standards, supra*. But the Board is now proposing to abandon its effort to reach the *right* result quickly and efficiently, in favor of reaching *any* result as fast as possible. Under FORR, even if the shipper's final offer was far below a maximum reasonable rate and the railroad's challenged rate was far above a maximum reasonable rate, the Board would have no discretion but to choose one or the other. That is, the Board might choose the shipper's final offer, even though the rate is below the "maximum rate" that would otherwise be objectively reasonable, *id.* § 10704(a)(1), or it might decide the challenged rate is better than the alternative, even though it believes the rate exceeds an objectively "reasonable" rate, 49 U.S.C. § 10701(d)(1). In these circumstances, regardless of how the Board exercised its remaining, limited discretion, its result would contravene the governing statute. The Board would therefore fail to carry out its congressionally delegated responsibility to protect the public interest.

Unsurprisingly, the NPRM fails to identify any precedent for a federal agency to so completely abandon its statutory duty to protect the public interest by adopting a final offer procedure. In fact, the existing precedent counsels strongly against adopting FORR.

As support for its proposal, the Board points to the Three Benchmark test's procedure for selecting comparison group traffic. See NPRM at 4. However, as the Board acknowledges, that final offer procedure "is only one part of the [test's] rate reasonableness approach." *Id.*¹ In fact, among other elements tying the Three Benchmark test to CMP principles is a provision allowing parties to submit evidence of "other relevant factors," after applying the Three Benchmark test's standard calculations, "to demonstrate that the maximum lawful rate should be higher or lower." *Simplified Standards*, slip op. at 22. In other words, the Board recognized the Three Benchmark test provides only a crude, rough application of CMP principles, so it established a safety valve that allows the Board to exercise its expertise and adjust the test's final results, thus fulfilling its responsibility to safeguard the public interest in accurate rate regulation.

At least one court has expressly rejected a federal agency's use of a final offer approach where, as here, the relevant statute required the agency to determine the *right* result, not choose between competing offers. In *Stone v. U.S. Forest Service*, 2004 WL 1631321 (D. Or. July 16, 2004), which involved a dispute over the "fair market value" of certain real estate, the court rejected agency guidance calling for competing appraisal reports to be evaluated using "a 'baseball-arbitration'-style procedure, in which the decisionmaker simply chooses between the two reports, even though the actual fair market value may be somewhere in between those two values." *Id.* at *3. The court said the agency's approach warranted reversal even under a highly

¹ In the only Three Benchmark case to reach a court of appeals, "neither party challenge[d] the validity of the framework itself." *Union Pac. R.R. v. STB*, 628 F.3d 597, 601 (D.C. Cir. 2010).

deferential arbitrary and capricious standard of review. As it explained, the relevant statute required the agency to determine the “fair market value,” not the “‘better’ of the two appraisals,” and “[b]aseball-style arbitration’ is not a procedure well-tailored” to calculating “fair market value.” *Id.* at *7. The same principle applies in rail rate cases.

Union Pacific is aware of one other federal agency that uses final offer procedures, but those procedures contain a safety valve to ensure appropriate consideration of the public interest. The Federal Communication Commission adopted rules for arbitrating interconnection disputes between incumbent local exchange carriers and other telecommunications carriers. Under the governing statute, interconnection rates must be “just and reasonable.” 47 U.S.C. § 252(d)(1); *see also id.* § 251(c)(2)(D). The FCC rules provide for final offer arbitration, but they do not require the arbitrator simply to choose the better of the two offers. Rather, the arbitrator must ensure the offers comply with statutory standards. If they do not, the rule gives the arbitrator discretion to decide how to proceed to ensure compliance with the statute. Specifically, the arbitrator has “discretion to take steps designed to result in an arbitrated agreement that satisfies the requirements of [the statute], including requiring parties to submit new final offers . . . , or adopting a result not submitted by any party.” 47 C.F.R. § 51.807(f)(3). In other words, the FCC’s rules do not bind the arbitrator to select one of the parties’ submissions.

The NPRM also notes the use of a final offer process under the Association of American Railroads’ Car Hire Rules, but that example does not support the Board’s proposal. A petition seeking review of the ICC’s car hire rulemaking, including its approval of the arbitration process, was dismissed on procedural grounds – the court refused to allow Southern Pacific to replace Chicago and North Western Railroad as petitioner when CNW withdrew its appeal. *See S. Pac. Transp. Co. v. ICC*, 69 F.3d 583, 584–85 (1995). However, one judge would have reached the

merits, and she would have held the arbitration provision violated the statutory car hire provision because the arbitrator was precluded from making a finding of market value in accordance with the statutory standards and was “limited instead to choosing between the offers of the parties.” *See id.* at 596 (Rogers, J., dissenting). Moreover, the car hire arbitration process reflects a voluntary agreement affecting a narrow, largely deregulated area – a very different context from the rate regulation at issue here. But even in this context, the use of final offer arbitration was controversial. If the parties’ voluntary agreement would not justify disregarding statutory standards, certainly the Board could not, entirely of its own accord, choose expediency over its role as guardian of the public interest.

The Board has no authority to establish a maximum rate unless it *itself* determines the challenged rate is unlawful. If the Board prescribes rates, it must prescribe them at the maximum reasonable level, not at some lower amount. These determinations require the Board objectively to measure challenged rates against statutory standards, not select between competing proposals. We elaborate on this point in Part III.

III. FORR WOULD PREVENT THE BOARD FROM APPLYING CONGRESSIONALLY MANDATED STANDARDS.

The FORR proposal is fundamentally incompatible with the congressionally mandated system of rate regulation in the United States. Congress did not authorize the Board to determine whether challenged rates are reasonable or prescribe maximum rates based on competing railroad and shipper rate proposals. A railroad generally may establish “any rate” for the transportation it provides. 49 U.S.C. § 10701(c). However, if a railroad has market dominance, its rates must be “reasonable.” *Id.* § 10701(d)(1). If the Board determines a railroad has market dominance and the challenged rate is not reasonable, it may prescribe the “maximum rate . . . to be followed.” *Id.* § 10704(a)(1). Any prescribed rate must be the “maximum reasonable rate” the railroad

could lawfully charge under the statute. See NPRM at 10 (“Each party’s final offer should reflect what it considers to be the maximum reasonable rate.” (citing 49 U.S.C. § 10704(a)(1))); see also *Consumers Energy Co. v. CSX Transp., Inc.*, NOR 42142, slip op. at 3 (STB served Aug. 2, 2018) (describing modifications to “prescribed maximum reasonable rates”); *W. Fuels Ass’n, Inc. v. BNSF Ry.*, NOR 42088, slip op. at 1 (STB served July 21, 2014) (discussing orders “prescribing maximum reasonable rates”).

To determine whether a challenged rate is reasonable, the Board must evaluate the rate in light of the rail transportation policy in 49 U.S.C. § 10101 and the Long-Cannon factors in 49 U.S.C. § 10701(d)(2)(A)–(C), while also recognizing the policy that rail carriers should have an opportunity to earn adequate revenues, as required by 49 U.S.C. §§ 10701(d)(2) and 10704(a)(2). In 1985, after years of study and effort, the ICC incorporated these factors in a set of maximum rate guidelines based on an approach called CMP, which includes the stand-alone cost (“SAC”) test. See generally *Coal Rate Guidelines*, *supra*. In 2007, after years of additional efforts, the Board adopted two CMP-based, streamlined, and simplified methods for determining the reasonableness of rates and, when necessary, prescribing maximum reasonable rates. See generally *Simplified Standards*, *supra*.

All three of the Board’s current methods of judging rate reasonableness and prescribing maximum rates have two common, critical features, apart from their grounding in CMP: (1) the Board determines whether a challenged rate is reasonable by measuring it against the maximum reasonable rate calculated using the statutory criteria; and (2) if the Board finds the challenged rate is not reasonable, it allows the railroad to charge the highest rate it would find reasonable.

By contrast, under FORR, the Board would not determine whether a challenged rate is reasonable by measuring it against the maximum reasonable rate calculated using the statutory

criteria.² Instead, the Board would apparently judge whether the challenged rate is unreasonable by somehow comparing it to the shipper's final offer. See NPRM at 13. Regardless of how the Board would actually perform the comparison – it provides no real explanation in the NPRM – nothing in ICCTA allows the Board to determine whether a challenged rate is reasonable based on a comparison to an alternative rate proposed by a complaining shipper. Under ICCTA, rate reasonableness is not to be judged in relation to other proposed rates. It is to be judged in relation to the economic criteria established by Congress. Congress did not direct the Board to determine which of two options is “more reasonable” or “less unreasonable.” Rather, Congress directed the Board *itself* to judge whether the railroad, which is generally entitled to set any rate it wants, see 49 U.S.C. § 10701(c), has established a rate that is “reasonable,” *id.* § 10701(d)(1).

In addition, under FORR, if the Board finds the challenged rate to be unreasonable, it would not necessarily allow the railroad to charge the highest rate it would find reasonable. In 49 U.S.C. § 10704(a)(1), Congress commanded that when the Board prescribes a rate, it must prescribe the *maximum* reasonable rate the railroad could charge. However, as discussed above, the FORR approach is not designed to identify the maximum reasonable rate based on statutory criteria. FORR is instead designed to select between competing proposals, neither of which would necessarily be the maximum reasonable rate determined in relation to the economic criteria established by Congress.³ Congress has not authorized the Board to prescribe a

² To the extent that, under FORR, the Board would calculate the maximum reasonable rate but still prescribe a lower rate, that outcome would be particularly arbitrary and capricious. The Board would in essence be ignoring a result it knows is correct and affirmatively adopting a result it knows to be incorrect.

³ In fact, as discussed in Part IV, in practice, the Board could never actually select the railroad's proposal as the maximum reasonable rate because if the challenged rate is reasonable, it would not have authority to prescribe a rate.

maximum rate lower than the maximum reasonable rate a railroad could charge. Thus, the FORR proposal again would be inconsistent with the statutory scheme established by Congress.

The FORR proposal is designed to resolve rate disputes expeditiously. However, when the Board evaluates the reasonableness of rates and prescribes maximum rates, it is not merely resolving disputes between private parties; rather, the Board is implementing Congress's rail transportation policies. The FORR proposal is fundamentally inconsistent with those policies, which allow railroads to set their rates at the maximum level consistent with statutory criteria to ensure they are not subsidizing traffic and they are earning the revenue needed to maintain a safe and efficient rail system.⁴ Those statutory maximum rate levels cannot be determined – and the Board's congressionally mandated duties discharged – by using a procedure that simply selects between competing proposals.

IV. THE FORR PROPOSAL CONTAINS CONCEPTUAL FLAWS THE BOARD FAILED TO ADDRESS.

In addition to violating the Board's statutory duty, the FORR proposal is arbitrary and capricious because the FORR procedure suffers from fundamental conceptual flaws preventing it from functioning as the Board intends.

A. The Board could never select a railroad's final offer.

In proposing FORR, the Board failed to consider an inevitable consequence of the rule's design: the Board could *never* select the carrier's final offer rate as the maximum reasonable rate. Under FORR, the Board would consider the parties' final offers only if it first found the challenged rate to be unreasonable – and thus prohibited by statute. But, as a practical matter,

⁴ By adopting a regulatory scheme under which it could prescribe rates lower than the maximum reasonable rates permissible under statutory criteria, the Board would not only be acting contrary to congressional policies, it would be fueling arguments by other shippers that their rates should be reduced because they are bearing too great a share of the carrier's revenues. See 49 U.S.C. § 10701(d)(2)(C).

the railroad's final offer will be equal to or exceed the challenged rate – otherwise, the railroad would be conceding the challenged rate is unreasonable.⁵ Thus, if the Board finds the challenged rate is unreasonable, it has no choice but to select the shipper's final offer – the Board would be prohibited by statute from selecting the railroad's final offer (which would equal or exceed the rate it found unreasonable). In fact, even if the shipper fails to prove the challenged rate is not reasonable, the Board still would not select the railroad's offer – it cannot prescribe a maximum rate *unless* it first finds the challenged rate is unreasonable. This asymmetry also gives shippers advantages over railroads in pre-litigation commercial negotiations and developing their final offers for litigation.

Under ICCTA, the Board has authority to prescribe maximum rates only if it first finds (1) the railroad has market dominance, and (2) the challenged rate is not reasonable. *See* 49 U.S.C. § 10701(d)(1) (“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.”); *id.* § 10704(a)(1) (“When the Board . . . decides that a rate charged or collected by a rail carrier . . . does or will violate this part, the Board may prescribe the maximum rate . . . to be followed.”). As applied to FORR, this statutory framework means the Board must find the railroad has market dominance and is charging an unreasonable rate before it can even *consider* prescribing either of the parties' final offers. The Board apparently agrees. It says: “*If the Board finds that . . . the defendant carrier has market dominance . . . and*

⁵ In fact, no railroad would ever submit a final offer above the challenged rate. To prevail, a railroad would only need to show the challenged rate is reasonable. If the railroad succeeds in that endeavor, the Board would dismiss the complaint – the Board would never get to a point where it prescribes the railroad's final offer.

that the challenged rate is unreasonable, the Board would then choose between the parties' final offers." NPRM at 13 (emphasis added).

However, the FORR proposal would never work as the Board describes because the Board cannot prescribe a rate it has found unreasonable: if the Board finds a railroad has market dominance, its rate "must be reasonable." 49 U.S.C. § 10701(d)(1). If the challenged rate is *not* found unreasonable, the Board will never select between the parties' offers – it may prescribe a maximum rate *only* if the challenged rate is unreasonable. But if instead the challenged rate *is* unreasonable, the Board would be *required* to select the shipper's offer because, by the point in the proceeding when the Board selects a final offer, it would have already found the railroad's rate to be unreasonable, and thus it would be prohibited by statute from selecting the railroad's offer. The Board fails to consider and address this critical – and fatal – flaw in its proposal. See *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

The NPRM hints at one way in which the Board might select a railroad's final offer, but it is entirely unrealistic. In discussing awards of relief, the Board suggests it could choose the railroad's final offer "if it is below the challenged rate." NPRM at 14. But no railroad would ever submit a final offer below the challenged rate. The FORR proposal requires "[e]ach party's final offer [to] reflect what [the party] considers to be the maximum reasonable rate." NPRM at 10. Thus, a railroad submitting a final offer below the challenged rate would be conceding the challenged rate was unlawful – it would forfeit any opportunity to prevail. Moreover, a railroad would only litigate a FORR case if it believes the challenged rate is reasonable. A railroad that believed its rates were unlawful would instead offer lower rates in commercial negotiations, at which point either the parties would reach agreement before commencing any litigation, or the challenged rates would be rates the railroad was prepared to defend. And even if a railroad did

succumb to the pressure to submit a final offer below the challenged rates to have some chance of having its final offer selected, that would simply highlight the inequitable nature of the FORR proposal: shippers face no comparable pressure to undercut their negotiating positions. The Board does not acknowledge, much less justify, its creation of this inequity. *See Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016).

The same basic flaw in the FORR proposal – the very different incentives railroads and shippers confront in developing their final offers – would give shippers significant, asymmetric advantages in pre-litigation commercial negotiations and litigation under FORR. While railroads could not submit final offers *below* their challenged rates without conceding unreasonableness, shippers would face no comparable penalty – indeed, no penalty at all – if they end up submitting final offers *above* their last commercial offer (in an attempt to appear more reasonable before the Board). This imbalance gives shippers far greater leeway than railroads to maintain aggressive positions in commercial negotiations. In addition, because shippers would have the flexibility to depart from their commercial positions once they enter into litigation, shippers, unlike railroads, could take advantage of discovery obtained through FORR procedures to refine their final offers. The Board does not acknowledge, much less justify, these unfair advantages FORR would provide shippers. *See id.*

B. FORR creates incentives for shippers to engage in gamesmanship.

In proposing FORR, the Board failed to consider three other important imbalances that together would provide shippers with significant opportunities to engage in strategic behavior and would likely generate much more shipper-driven litigation than the Board is anticipating: (1) the shipper would not be required to move any traffic at the challenged rate if the railroad prevails; (2) the ICCTA contains no standard for judging a shipper's final offer unreasonably low; and (3) the shipper would know the railroad's final offer, before revealing its final offer,

and it would not reveal its own final offer until after discovery is closed. As a result of these factors, shippers would have strong incentives to set their final offers extremely low and take their chances with litigation.

As a result of the imbalances described above, a shipper would have nothing to lose, and much to gain, by rejecting a railroad's commercial rate offer, filing a complaint, and setting its final offer extremely low. The shipper would know its worst-case outcome would be paying a rate it could have accepted before litigation. If the shipper considers the rate too high, it would not be required to use the rate to move traffic, even if the rate is found reasonable.⁶ The shipper would also know it can readily defend the reasonableness of its final offer: if the railroad can defend the challenged rate as reasonable, the shipper can plainly defend an even lower rate as reasonable – rate reasonableness has an upper limit, but no lower limit. In fact, a shipper would never need to defend its own final offer to prevail. It can simply focus all its efforts on showing the challenged rate is *not* reasonable. To take an extreme example, a shipper could set its final offer at \$1 per car, then focus on showing the challenged rate is \$1 above the reasonable level. Under FORR, if the shipper shows the challenged rate is not reasonable, the Board has no choice but to prescribe the shipper's rate, no matter how low, because it cannot prescribe an unreasonable rate. *See* 49 U.S.C. § 10701(d)(1).⁷ FORR thus would provide shippers a

⁶ Canada's final offer rate dispute procedure is a statutory procedure and reflects a different balancing of public and private interests by Parliament than Congress struck in ICCTA. Notably, however, Canada appears to address some of this potential imbalance through rules that require "an undertaking by the shipper to ship the goods to which the arbitration relates in accordance with the decision of the arbitrator." Canada Transp. Act., S.C. 1996, c. 10, as amended § 161(2)(c).

⁷ To the extent that such an outcome would result in requiring carriers to operate at or below marginal cost, the proposed rule would lead to unconstitutional, confiscatory rates. *See Fed. Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 603 (1944) (rate setting should allow "enough revenue not only for operating expenses but also for the capital costs of the business").

tremendous incentive to roll the dice by proposing extremely low rates in final offers.⁸ These significant shipper incentives and advantages are magnified by the FORR procedural schedule. Obviously, a shipper would know the challenged rate before filing a complaint. See NPRM at 13. By contrast, the railroad would not know the shipper's final offer until Day 35 of the proceeding – *i.e.*, after discovery has closed. See *id.* at 14. Shippers thus would have at least 50 days and the benefit of discovery to develop their attack on the challenged rate, while railroads would have only 10 days, and no opportunity for discovery, to address shippers' final offers. See *id.*

The FORR procedures would not give railroads any ability to counteract these shipper advantages. In particular, a railroad facing potential litigation could gain no offsetting leverage by setting the challenged rate (or its final offer) any higher than the rate it is willing to offer the shipper in commercial negotiations. In many situations, a railroad will not set its rate as high as the maximum rate that would be permitted under an application of the statutory factors because market forces, including intermodal, geographic, and product competition, constrain its pricing.⁹ However, even if a railroad believed a challenged rate was below the maximum reasonable rate, it would not set its rate any higher because (i) setting the rate higher would make it more likely to lose the reasonableness challenge, and (ii) even if it prevailed, the shipper would never pay more than the market price. The Board does not acknowledge, much less justify, the significant imbalances faced by railroad and shipper litigants under the FORR proposal and how they would

⁸ The Board's purported requirement that a shipper's final offer should reflect what it considers to be the maximum reasonable rate, see NPRM at 10, is entirely unenforceable. Indeed, the Board's use of "should" makes it unclear whether this is an actual requirement.

⁹ The Board's purported requirement that a railroad's final offer should reflect what the railroad considers to be the maximum reasonable rate, see NPRM at 10, if taken literally, would in many cases require railroads to defend higher rates than they actually want to charge.

affect FORR's application. *See Encino Motorcars*, 136 S. Ct. at 2125. Similarly, the proposed rule's failure to consider or protect against the risk of gamesmanship is arbitrary and capricious. *See Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1525 (D.C. Cir. 1984) (finding proposed rate regulation arbitrary and capricious, in part, because agency failed to consider the proposal "invite[d] an enormous amount of gamesmanship").

C. The Board's theoretical justifications for adopting FORR do not apply in this context.

In proposing FORR, the Board failed to consider why a final offer procedure modeled on baseball arbitration is not suitable for resolving rate cases. We already addressed the two most important reasons above and will not belabor them here: *First*, unlike a baseball arbitrator, the Board is a congressionally established government body with a *duty* not only to resolve disputes between parties, but also to ensure the resolution is consistent with the broader public interest. *Second*, unlike a baseball arbitrator, the Board has statutory standards that it must apply in determining whether its resolution of disputes is consistent with the public interest.

The Board also failed to consider a *third* reason final offer procedures are incompatible with rate reasonableness disputes: the theoretical justification for using a final offer approach – that mutuality of risk will drive parties toward presenting reasonable final offers – is not present in the rail context. Specifically, the literature on which the Board relies makes clear the theoretical justification for using a baseball-style final offer mechanism is to avoid the “chilling effect” on negotiations that arises from the perception that arbitrators have a tendency to “split the difference” between each party's positions. *See* NPRM at 5.¹⁰ If the parties know the

¹⁰ Citing Josh Chetwynd, *Play Ball? An Analysis of Final-Offer Arbitration, Its Use in Major League Baseball, & Its Potential Applicability to European Football Wage & Transfer Disputes*, 20 Marq. Sports L. Rev. 109 (2009); Michael Carrell & Richard Bales, *Considering Final Offer* (continued...)

arbitrator is prohibited from splitting the difference and instead must select one of the final offers, the parties will submit reasonable final offers to reduce the risk of having the other side's offer selected. See Benjamin A. Tulis, *Final-Offer Baseball Arbitration: Contexts, Mechanics & Applications*, 20 Seton Hall J. Sports & Ent. L. 85, 89 (2010). The literature thus hypothesizes that "[w]hen *each party* feels pressured to make a more reasonable offer, the parties are brought together toward a middle ground, which promotes settlement prior to an arbitration hearing." *Id.* (emphasis added). However, this theoretical incentive for reasonableness would be absent under the FORR proposal because, as a result of the imbalances described in Section IV.B, the shipper would not feel pressured to make a more reasonable offer. Instead, as discussed above, the shipper would instead be incentivized to submit an extremely low final offer.

As also described above, a shipper would not feel pressured to make a more reasonable offer because the only rate actually at issue is the challenged rate. Under the FORR proposal, if the Board finds the challenged rate is not reasonable, it would have no choice but to select the shipper's final offer. Again, this is different from the baseball context, which has no statutory upper limit that would prevent the arbitrator from selecting a player's extremely high salary demand after rejecting an owner's unreasonably low offer.

The Board's apparent failure to consider the lack of shipper incentives to submit reasonable final offers is a significant oversight. The risk that parties will not submit reasonable final offers is one of the main criticisms of final offer procedures, even in circumstances that lack the risk for strategic behavior posed by the FORR proposal. See Carrell & Bales at 31; *see also*

(continued...)

Arbitration to Resolve Public Sector Impasses in Times of Concession Bargaining, 28 Ohio St. J. on Disp. Resol. 1 (2012).

J. Gregory Sidak, *Mandating Final-Offer Arbitration of FRAND Royalties for Standard-Essential Patents*, 18 Stan. Tech. L. Rev. 1, 6–7 (2014).

Finally, the Board fails to consider a critical procedural difference between the FORR proposal and baseball arbitration. In baseball arbitration, each party learns the other party's final offer at the same time, and each party has the same opportunity to develop evidence supporting its proposal and opposing the other party's proposal. But under the FORR proposal, a shipper would not be required to reveal its final offer until after the railroad's offer (*i.e.*, the challenged rate) is locked in, meaning only the railroad's offer would be subject to discovery. See NPRM at 13–14.

V. THE BOARD'S STATED JUSTIFICATION FOR PROPOSING FORR'S FINAL OFFER PROCEDURE IS LOGICALLY FLAWED.

The Board's stated justification for proposing its FORR approach is to "constrain[] the cost and complexity of rate litigation." NPRM at 14. However, the Board's rationale does not justify adoption of FORR's final offer approach.

Although the Board treats the FORR procedure as one proposal, it is actually comprised of at least two distinct parts: (1) a set of rules providing for expedited discovery and briefing, and (2) a set of rules governing the rate reasonableness determination. Neither of these parts is necessarily contingent on the other. The Board could adopt rules for expedited discovery and briefing in rate cases without applying a final offer approach for resolutions on the merits.

The Board's desire for a less costly, less complex dispute resolution mechanism might justify adopting rules providing for expedited discovery and briefing, but it does not justify the final offer aspect of the FORR proposal. The FORR proposal's final offer approach – which abandons reliance on CMP in favor of what the Board calls "principle-based, non-prescriptive criteria" for selecting between final offers, see NPRM at 11 – actually promises to increase

substantially the cost and complexity of rate cases. In the absence of clearly defined criteria, railroads and shippers would have no choice but to devote significant resources to FORR proceedings, offering the Board multiple analyses in the hope that one will strike a chord or that one more analysis will swing the balance in their favor.¹¹ And the Board is mistaken if it believes a 40-day period between the shipper's notice of intent and first evidentiary filing would not be enough time to generate significant costs and complex analyses. Moreover, shippers would have far more than 40 days to develop their evidentiary submissions because they would control the timing of their complaint. Railroads would necessarily spend the time and money required to respond, especially given the Board's proposed case-by-case approach to fleshing out its criteria, which raises the stakes for each case. This same dynamic – the Board's promulgation of insufficiently-defined rules that incentivized costly litigation – was likely what doomed the Board's 1996 rate guidelines for non-coal proceedings. *See Rate Guidelines – Non-Coal Proceedings, supra*. And the 90 days the Board now proposes to grant itself to decide each case, *see NPRM* at 14 – the same amount of time as for a Three Benchmark case, *see Simplified Standards*, slip op. at 23 – appears to be a recognition that deciding cases under the FORR proposal would require the evaluation of complex, competing evidentiary submissions.

If the Board simply wanted to reduce the cost and complexity of rate litigation, it could instead adopt procedures to expedite Three Benchmark cases. Union Pacific previously suggested the Board could reduce number of rounds of evidentiary filings from three to two (as proposed in FORR), which would cut 30 days from the procedural schedule. Discovery could begin immediately upon the filing of the complaint (as proposed in FORR), which would cut

¹¹ The Board seems to acknowledge this likelihood. The Board states that its “non-prescriptive criteria” are “intended to allow for innovation with respect to rate review methodologies” and “create[] incentives for methodological improvements.” *NPRM* at 11–12.

another 30 days from the procedural schedule. Because the Board would not need to develop new rate reasonableness standards on a case-by-case basis, it could reduce its time to decide cases from 90 days to 60 days, which would cut another 30 days from the procedural schedule. At that point, the Three Benchmark schedule would be just 15 days longer than the proposed FORR schedule, and parties would save substantial time and costs because they would not need to wrestle with the Board's "non-prescriptive criteria" and appeals of the Board's application of unique or unexplored criteria in each case (not to mention the inevitable appeal of the FORR proposal itself).

VI. OTHER ASPECTS OF FORR ARE FUNDAMENTALLY FLAWED.

Even if the Board could adopt the FORR's final offer approach for rate reasonableness determinations, it could not adopt the proposed FORR procedural schedule and discovery process or the proposed \$4 million cap on relief.

A. The proposed procedural schedule and discovery process violate due process.

FORR's proposed schedule and discovery process would place railroads at a significant procedural disadvantage to shippers and, as a result, would violate their due process rights.

Proceedings authorized by FORR could be initiated only by a shipper filing a complaint with the Board – that is, the shipper controls the timeline. *See* 49 U.S.C. §§ 10704(b), 11704(b). A shipper initiating a proceeding would obviously know the challenged rate, and as explained above, once it knows the challenged rate, it also knows the railroad's final offer – the two will inevitably be the same. *See supra* p. 12 & n.5. Indeed, a shipper could potentially know the railroad's final offer *two years* before filing its complaint – a shipper can file a rate case up to two years after the claim accrues. *See* 49 U.S.C. § 11705(c). By contrast, under the proposed schedule, the railroad would not learn the shipper's final offer until much later – the shipper would not disclose its final offer until 35 days after filing its complaint. *See* NPRM at 14.

This arrangement fundamentally favors shippers over railroads. A shipper would have up to a two-year period to develop a record demonstrating the alleged unreasonableness of the challenged rate. By contrast, a railroad would have 40 days from when it receives notice of a shipper's intent to file a complaint to develop support for the challenged rate, and it would have just 10 days after learning the shipper's final offer to develop a response. *See* NPRM at 13–14.

This asymmetric arrangement is exacerbated by the FORR proposal's discovery rules. Under the FORR proposal, discovery would end even *before* the shipper must disclose its final offer. *See* NPRM at 13–14. Thus, not only would the shipper know the railroad's final offer and be able to prepare its case long before the railroad knows the shipper's final offer, but the shipper also would be able to conduct discovery regarding the railroad's final offer, while the railroad would have no opportunity to conduct discovery regarding the shipper's final offer. The Board fails to acknowledge this critical asymmetry, much less justify the benefits it provides shippers.

If the Board were to move forward with FORR, it would have to modify the proposal to address this major procedural disadvantage. The Board could not allow a shipper to spring its claim on a railroad long after the railroad established the challenged rate. The shipper would have to alert the railroad of its intent to pursue a case using the FORR method and provide its own final offer whenever it asks the railroad to establish a rate it could challenge. *See* 49 U.S.C. § 11101; 49 C.F.R. § 1300.3.

Modifying the FORR proposal in this regard would not only be consistent with basic fairness, it would be consistent with the basic justification for using a final offer approach. As the Board recognizes, final offer procedures are used because they encourage parties to negotiate toward middle ground and spur negotiated settlements. *See* NPRM at 5. These benefits cannot be obtained unless parties know during their negotiations that the consequence of failing to settle

will be a final offer proceeding. In other words, the FORR final offer approach would not serve its basic purpose if a shipper could decide up to two years after the fact to invoke the process.

In addition, if the Board were to move forward with FORR, it would have to develop actual procedures for resolving discovery disputes. The Board's current proposal for addressing failures to provide discovery would prejudice railroads. It provides no viable means for railroads to deter discovery violations by shippers, while shippers could deter violations by railroads. The proposed rule says "[n]o litigation over discovery disputes would be permitted," and that instead the Board would somehow take into account a party's unreasonable withholding of discovery "in making its final decision" – *i.e.*, in selecting a final offer. NPRM at 8. However, as explained above, the Board could never punish a shipper for discovery violations by selecting the railroad's final offer, because it would never select the railroad's final offer: if the shipper cannot prove the challenged rate is unreasonable, it would dismiss the case; if it can, the Board would be prohibited from selecting the railroad's final offer. *See supra* Part IV. Shippers would have no motivation to comply with discovery obligations if the only potential consequences are illusory.

Union Pacific does not object to expedited procedures, as long as the procedures equally limit *both* parties' ability to develop and present their case. The Board's unbalanced approach would prevent railroads from obtaining a fair hearing. *See Wardius v. Oregon*, 412 U.S. 470, 475 (1973) (holding that discovery rule violated due process where defendants were not afforded "reciprocal discovery rights" because "discovery must be a two-way street").

B. The proposed \$4 million relief cap is arbitrary and capricious.

The FORR proposal includes a \$4 million cap on the relief that shippers could obtain pursuant to the FORR procedure. *See* NPRM at 16. Union Pacific supports capping the relief available under any FORR procedure, given the manifest flaws in the procedure that we have

identified above. However, the specific figure the Board has selected – \$4 million – is arbitrary and capricious.

The Board seeks to justify the \$4 million figure by equating the FORR procedure to the Three Benchmark test, and indicating that the rate cap should funnel higher-value cases into the Simplified-SAC test. *See id.* at 15–16. However, the Board simultaneously justifies the adoption of the FORR procedure on the basis that it would be more affordable to litigate than the Three Benchmark test. *See id.* at 2, 7. Thus, the rate cap should be designed to funnel into the Three Benchmark test, rather than the more costly and involved Simplified-SAC test. If the FORR procedure were just as expensive and accurate as the Three Benchmark test, there would be no need for the Board to adopt the proposed rule.

Similarly, although the Board states that the proposed FORR procedure would not be less precise than any pre-existing procedure because it “does not prescribe a particular methodology,” *id.* at 15, that assertion ignores the proposal’s significant discovery limitations and abbreviated timeline, which would inevitably sacrifice precision. Even if there were some uncertainty about precision, the Board does not explain why it is appropriate to assume FORR would be as precise as (or even more precise than) the Three Benchmark method in establishing the cap on relief.¹²

Finally, the Board also relies on the fact that Canada caps the relief available under its final offer framework. *See id.* at 16. But the Board fails to explain why it proposes to adopt a cap more than double that of Canada’s (\$2 million *Canadian* dollars, or about \$1.5 million U.S. dollars). That omission, too, renders the proposed rate cap arbitrary and capricious. *See State Farm*, 463 U.S. at 43.

¹² In addition, if the Board were to adopt its proposed Market Dominance Streamlined Approach, the cost of litigating Three Benchmark cases would fall, which would justify an even lower relief cap for FORR.

VII. CONCLUSION

The Board should not adopt FORR. Congress charged the Board with protecting the public interest when making rate reasonableness determinations and prescribing maximum rates. The Board cannot possibly fulfill its duty to the public or properly apply statutory standards for judging rate reasonableness by selecting only between rates offered by a shipper and a railroad. In addition, the Board failed to engage in reasoned decision-making. It fails to acknowledge the FORR proposal could not work as described and would create incentives for shippers to engage in gamesmanship that make its final-offer approach unsuitable for resolving rail rate disputes. The Board also fails to justify the asymmetric treatment of railroads and shippers under the FORR proposal's procedural schedule and discovery rules. The Board should not capitulate to the demands of shippers – shippers who cannot show their rates are unreasonable using sound economic principles – by abandoning its 35-year commitment to CMP.

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