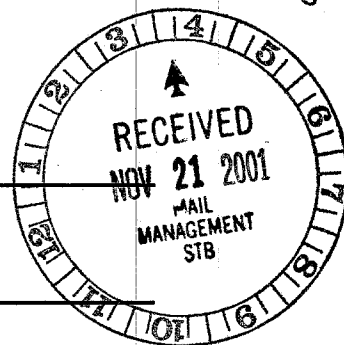


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BEFORE THE
SURFACE TRANSPORTATION BOARD



STB EX PARTE NO. 586

ARBITRATION – VARIOUS MATTERS RELATING TO ITS USE
AS AN EFFECTIVE MEANS OF RESOLVING DISPUTES
THAT ARE SUBJECT TO THE BOARD'S JURISDICTION

INITIAL COMMENTS BY THE
CANADIAN NATIONAL RAILWAY COMPANY
AND THE
CANADIAN PACIFIC RAILWAY COMPANY

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November 21, 2001

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On September 20, 2001, the Surface Transportation Board (“Board”) requested comments on whether Congress should prescribe mandatory arbitration for the settlement of small railroad rate disputes. The Canadian National Railway Company (“CN”) and the Canadian Pacific Railway Company (“CP”), hereinafter referred to collectively as the “Canadian Railways”, welcome the opportunity to provide the Board with comments regarding arbitration and various matters relating to its use.

I. Summary of the Canadian Railways’ Position

Through this submission the Canadian Railways wish to share with the Board their experience with legislated arbitration and newly introduced mediation under the Canadian rail regulatory regime. Because of a series of factors (which degree of relevance in the context of the U.S. rail regulatory regime may vary), it is the Canadian Railways’ position that mandated, legislated Final Offer Arbitration (FOA) has not been an effective means of resolving disputes between shippers and railways in Canada. With

this caveat, it is the Canadian Railways' position that caution should be exercised when examining the relevance of such or a similar mechanism as a means to resolve rail disputes, especially if the approach that is favored is for private-sector resolutions outside a formal process. In the Canadian Railways' views the FOA process has been shown to be complex, costly, time-consuming – while imposing a tight timeline, biased toward shippers and overly confrontational (especially for an arbitration mechanism). Above all, the FOA process has lacked a coherent and rational economic scheme to assess the appropriateness of each party's final offer. In contrast, the Canadian Railways see a newly introduced mediation process as constituting a very promising tool to allow shippers and railways to settle rate and services disputes in a more flexible, less costly, less time consuming, voluntary, collaborative and less confrontational environment.

II. Final Offer Arbitration

a. Background

FOA was introduced in the *National Transportation Act 1987* ("NTA 1987") at the same time confidential contracts and other significant rate-related measures were first brought into Canadian rail transportation legislation, and thus in the context of a significant reform of the Canadian regime for railways.

The FOA provisions (as they apply to rail) apply over rate or service disputes regarding the carriage of goods by federally-regulated railways, except domestic intermodal shipments (trailers or containers) and international (e.g., import or export) container shipments transported to or from a port served by two or more railways.

These provisions were amended twice. They were amended in 1996 when, as part of the review of the NTA 1987, passenger and commuter services were allowed FOA

process for rates proposed by railways under the *Canada Transportation Act 1996* ("CTA 1996"). Then, in 2000, Parliament introduced in the CTA 1996 provisions for the simultaneous submission of offers and for a streamlined process regarding disputes valued at less than C\$750,000 in freight charges.

Since the introduction of the mechanism in 1988, twenty-three FOAs have been initiated, most of which involving CN or CP. While some FOAs were minor, the vast majority were major disputes, with one even reaching some C\$25 million in annual revenues attritions for the railway. While it appears that the disputing parties have settled slightly more than half of the FOAs before the end of the arbitration process, the vast majority of those that completed the process were found in favor of the shippers.

b. Process

Provided the matter is not governed by a confidential contract, a shipper can apply to the Canadian Transportation Agency ("Agency") to refer the dispute to FOA. In its application, the shipper submits its final offer (excluding any dollar amounts) and undertakes to ship the goods in accordance with the arbitrator's decision. Subsequently, both the shipper and the carrier file simultaneously their final offers, including any dollar amounts. The Agency then communicates each party's final offer to the other. The carrier and the railway provide the arbitrator the information in support of their respective offers and a period is allowed for interrogatories. Although a file hearing (i.e., conducting the proceeding solely on the basis of a written record) is technically possible, a hearing is generally held.

The arbitrator has 60 days (more if parties agree) to either retain the shipper's final offer or that of the railway (if both parties so request reasons for decision must follow within the next 30 days). The arbitrator's decision must be based on the information originally submitted by the parties plus such other information the arbitrator may have requested from the parties. In making a decision, the arbitrator must have regard as to whether – in the arbitrator's opinion and absent any clear definition, there is available to the shipper an alternative, effective, adequate and competitive means of transporting the goods and all other considerations that appear relevant to the matter. Provided the parties agree, the arbitrator's decision is final and binding and applies for a period of one year (or less if agreed by the parties).

The summary process available since June 2000 for disputes involving freight charges under C\$750,000 eliminates interrogatories, allows parties seven days to respond to the final offer of the other, provides for a hearing if necessary and requires the arbitrator to issue its decision within 30 days of the shipper's application.

c. Canadian Railways' Assessment

The Canadian Railways' experience with legislated FOA is that generally such a baseball-type process of arbitration is not an effective means of resolving disputes between shippers and railways. The FOA is intrinsically flawed with major difficulties from legal, commercial and economical perspectives.

First, one of the basic grievances of the Canadian Railways regarding legislated FOA is that there is no competitive entry test. Consequently, any shipper can launch the FOA process even though they may be enjoying a competitive environment.

Second, as an alternate dispute resolution mechanism the FOA process is much more complex than it appears. As such, FOAs have led to many preliminary jurisdictional objections, requiring the involvement of the Agency, hence extending and further complicating the process and adding to it a fair amount of litigation and costs. This runs totally in contradiction with the original stated objective of creating a quick, inexpensive alternative to public hearings as a means of resolving disputes.

Third, the FOA process has an institutional, systemic bias toward shippers. Shippers unfairly control the timing for initiating the FOA. As a result, a shipper can engage a railway in a long negotiation process at the end of which the shipper can simply give the railway five days notice that it intends to apply for FOA. But more importantly, shippers neither assume risks nor have any exposure. They can invoke the FOA after having received from the railway a final rate quotation based on a wide range of considerations such as service, car supply, etc., and the assigned rate – the rate chosen by the arbitrator – cannot be higher than the one quoted by the railway in the negotiations.

Fourth, the proceedings and the tight timeline have been shown to require extensive corporate resources on both sides and to be quite confrontational. This has caused severe disruptions in the development of long-term *bona fide* commercial relationships between some shippers and the railways, also leaving a permanent sense of hostility between the persons involved, which again runs contrary to an industry-wide, efficient alternate dispute resolution mechanism.

Finally and perhaps more importantly, it makes little sense to have an arbitrator or a panel of arbitrators (even well qualified arbitrators, which is another issue) decide rate or service cases without the support of a coherent and rational economic scheme to assess

the appropriateness of each party's final offer. Compared with specially trained, seasoned mediators (see section III.b below), arbitrators under this system are practically on their own. Moreover, arbitrators may not have the requisite experience, they are provided absolutely no economic, commercial or legal guidance, and there is no body of law, nor any precedent established on which they can rely.

The Canadian Railways cannot therefore share the recent CTA Review Panel assessment that in Canada, on balance, and despite recognized concerns about the complexity and expense of FOA, the FOA provisions "adequately address the problem of carrier dominance and potential abuse in a way that is fair to both shippers and carriers". Based on their own experience, the Canadian Railways can attest that the FOA is neither adequate nor balanced and that it does not meet its original objectives.

d. Significance For The Proposal Before The Board

The Canadian Railways believe that mandated FOA in the U.S. would be no more successful than it has been in Canada. The experience in Canada confirms that the numerous concerns discussed below in this section are not merely theoretical; they are all too real. The Canadian Railways discuss these concerns in the same order as in the previous section where they assessed the Canadian experience.

First, market dominance. Any properly conceived arbitration proposal could only be a substitution for Board processes, not a substantive transformation of the statutory scheme. It is essential, therefore, that arbitration not be available in circumstances where rate determinations by the Board would not be available, namely, where the railroad lacks market dominance over the traffic in question. Otherwise, the arbitration provision would work a fundamental transformation in the basic policies of the ICC Termination

Act of 1995 ("ICCTA") by substituting a mandated arbitral decision for the market in circumstances where the market is in fact performing competitively.

Second, preliminary jurisdictional objections. The required market dominance test will inevitably lead to preliminary jurisdictional objections, reducing the utility of arbitration in comparison with proceedings before the Board.

Third, bias toward shippers. While mandated FOA might not, in and of itself, bias the process toward shippers, it does entail the same underlying risk, namely a distortion of negotiating positions. If the arbitrator is aware of the best offers of the parties in negotiations, he or she is very unlikely to choose a final offer by the railroad that exceeds the railroad's best offer in the negotiations, or a final offer by the shipper that is lower than the shipper's best offer. The effect would be to make negotiations less productive, because both parties, with an eye toward arbitration, would tend to be less forthcoming than they otherwise might be in the context of a negotiation. In negotiations, many aspects of the shipper-railroad relationship may be on the table, so that each party may find it worthwhile to make trade-offs that it would not make otherwise. Arbitration is a less subtle and often less inclusive process than negotiation, and tends to isolate the rate issue.

In theory, these undesirable effects might be avoided if the arbitration were protected by some kind of ironclad privilege that protects positions taken during the negotiation and ensures that the arbitrator is not made aware of them. The Canadian Railways believe, however, that shippers would oppose such a privilege. And, as a practical matter, effectively maintaining the privilege could prove difficult in the informal setting of an arbitration. Unlike in a court or in a proceeding before the Board, there is unlikely

to be any effective sanction. And, as is the case with this type of privilege generally, the railroad, in asserting a breach of the privilege, might be required in effect to confirm the very negotiation offer that it is seeking to protect.

Fourth, costs and confrontation. Arbitrations are adversary. The shift to a less formal forum does not generally eliminate complexity, the need for careful and often extensive proof, discovery, and an adversary process. Arbitration would not necessarily be more complex than rate proceedings before the Board, but it is unlikely on average to be significantly less complex.

Fifth, the need for a coherent and rational substantive scheme. The ICCTA and Board decisions governing rate regulation represent carefully developed policies that provide rate protections to shippers while providing railroads with the opportunity to compete and earn an economic return. Any system that ignores the need for an economic return is, in effect, authorizing subsidies, in which certain arbitrated rates do not adequately contribute to meeting the railroad's revenue requirements, which, over time, must then be satisfied through rates on other traffic or not at all. If arbitration were used to allow such a system, it would be changing fundamentally the policies and standards of ICCTA, and could be creating perverse incentives to challenge rates in arbitration that a shipper would not challenge under the proper standards.

Again, in theory, the law could require an arbitrator in FOA to be guided by the ICCTA and by STB and ICC precedent. However, the Canadian Railways do not believe that this is how the proponents of FOA conceive it. The proponents will argue, correctly, that such a requirement would diminish any differences between arbitration and proceedings before the Board. And, where the statute and precedent would indicate a rate

different from the final offer of either party, the arbitrator would nonetheless be required to choose one of the final offers. Further, if arbitration decisions themselves lack precedential value, parties in each arbitration are proceeding without the benefit of the arbitration that has gone before, which is less efficient than where precedents are known and can be utilized. In such a system, the most litigious parties may have an advantage over those who resort to the process only infrequently.

These concerns are grounded in the experience of the Canadian Railways with the Canadian system of FOA. While the Canadian Railways appreciate that rate regulation might be governed by a different system, it is unlikely that any one mandated FOA system could avoid all of the significant shortcomings demonstrated in Canada, or that, if it did so, it would offer reductions in complexity, cost and loss of economic efficiency that would warrant establishing a parallel system of rate regulation.

III. Mediation

a. Background

No doubt recognizing the difficulties of the FOA process and the need for a less complex dispute resolution mechanism, the Agency launched a mediation process in June 2000 in the form of a pilot project for the rail and marine sectors. The mediation process is meant to provide “an alternative to a more formal adjudicative process” and is said to constitute “a more flexible, less costly, less time consuming, voluntary, collaborative and less confrontational” mechanism.

b. Process

Any party to a dispute may submit a Request to Mediate to the Agency. Unless the parties file the request jointly, the Agency contacts the other party to determine its willingness to mediation. Should mediation proceed, a mediator (i.e. members or staff of the Agency previously trained in this capacity) contacts the parties to discuss the ground rules, the processes for the exchange of information, the time and location of mediation.

As mediation is designed so that the parties themselves find a mutually agreed solution, it is also for them to agree on a common definition of the facts and issues. Also, from the very outset the parties must be committed to exploring all of the options to resolve areas of disagreement since this will clear the path for a quick resolution of the dispute.

At all times during this process, the role of the mediator is akin to that of a facilitator. The mediator makes sure the parties remain focused on the issues to be solved and that they maintain open the lines of communication. Because mediators bring to the parties their resident expertise and experience, they can also provide parties the necessary feedback on the discussions and makes sure all options presented are examined.

If the parties reach a settlement, the mediator can assist in preparing the minutes of settlement. There can be a partial settlement, in which case the remaining issues may be dealt with by the Agency under the existing rules, or there can be no agreement at all, in which case the complete file may return to the Agency. Since mediation is confidential, any unresolved issues that is sent back to the Agency remains confidential, which means, among other things, that the mediator can neither discuss the file nor work on the file.

c. Canadian Railways' Assessment

Although limited in number, the experience of the Canadian Railways with respect to mediation as a mean of resolving rail-related dispute is so far very positive. Key in the success of the mediation process is its non-confrontational character. Combined with the absence of strict legal evidentiary and procedural rules, the conciliatory nature of the mediation process allows parties frank, open, even candid discussions. This dynamic allows a reconciliation of the facts and issues to be addressed, which, ultimately, fosters mutually agreed solution. This, in turn, contributes in building better long-term relationship between shippers and railways.

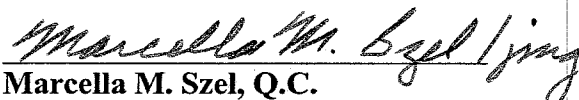
IV. Conclusion

Canadian Railways are of the view that a mandated, legislated FOA-type arbitration process contains many disadvantages for both parties, compared to the advantages of mediation, especially in the context where the purpose of an alternate means to resolve rail disputes is to favor private-sector resolutions outside a formal process.

Respectfully submitted,


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