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204265

January 3, 2002



The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, NW (#700)
Washington, DC 20423-0001

RE: 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

Dear Secretary Williams:

Enclosed are ten (10) copies of the reply comments of the Railway Progress Institute in the matter of STB Ex Parte No. 586. I hope they can be made part of the official record of the proceeding.

Thank you.

Sincerely,

A handwritten signature in black ink, which appears to read 'Robert A. Matthews'.

Robert A. Matthews

M/d
Enclosures

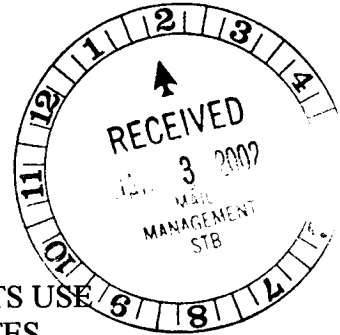
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Office of the Secretary

JAN 13 2002

U.S. DEPT. OF
TRANSPORTATION

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

ENTERED
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Part of
Public Record

REPLY COMMENTS OF
THE RAILWAY PROGRESS INSTITUTE

ROBERT A. MATTHEWS
President
Railway Progress Institute
700 N. Fairfax Street
Suite 601
Alexandria, VA 22314
(703) 836-2332

Dated: January 3, 2002

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 586

ARBITRATION – VARIOUS MATTERS RELATING TO ITS USE
AS AN EFFECTIVE MEANS OF RESOLVING DISPUTES
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REPLY COMMENTS OF
THE RAILWAY PROGRESS INSTITUTE

The Railway Progress Institute (“RPI”) hereby submits these reply comments in response to the Surface Transportation Board’s (“Board”) decision dated September 20, 2001 (“Decision”), in this proceeding.

RPI is an international association of suppliers to this nation’s freight and passenger rail systems. RPI’s goals are, among others, to support and promote a strong, free-enterprise system of freight railroads and to represent and further the interests of its members. Railway supply companies employ more than 150,000 individuals and sell more than \$20 billion annually in equipment, supplies and services to the nation’s rail systems. Of the 1.4 million freight cars that exist today, RPI members own, operate or manage 470,000 cars, or about 34 percent of all freight cars on the railroads today.

The following comments represent a minority of RPI member freight car owners and specifically excludes GE Capital Railcar Services Corporation at this time.

In the Decision, the Board seeks comments as to whether mandatory binding arbitration, particularly “baseball-style” arbitration, should be legislatively required for small rail rate disputes. RPI and its members have only indirect economic interest in railroad-shipper rate disputes or the manner in which they are resolved. Several parties, however, have suggested that the scope of this proceeding be expanded to address a much broader range of disputes that would be made subject to mandatory arbitration.¹ Because a number of these other issues suggested for mandatory arbitration are of interest to certain RPI members, RPI is submitting these reply comments on behalf of those members.

In the Decision, the Board refers to the Canadian “baseball-style” arbitration for rail rate disputes and a number of parties cite the Canadian arbitration process both in support and in opposition to the Board’s proposal.² No one in this proceeding, however, appears to have addressed the mandatory arbitration process for car hire disputes in this country that was adopted by the Board’s predecessor, the Interstate Commerce Commission (“ICC”) in *Railroad Car Hire Compensation – Rulemaking*, 9 I.C.C.2d 80 (1992) and 9 I.C.C.2d 1090 (1993), *appeal dismissed in Southern Pac. Transp. Co. v. ICC*, 69 F.3d 583 (D.C. Cir. 1995) (“*Car Hire Rulemaking*”).³ A number of RPI members have had less than a satisfactory experience with Car Hire Arbitration and consider that system to be fundamentally flawed. RPI, therefore, urges the

¹ For example, by petition filed October 9, 2001, the National Industrial Transportation League (“NITL”) seeks to have this proceeding broadened to include such disputes as rail classifications, allowances, demurrage and car service issues.

² For example, Canadian National Railway Company (“CN”) and the Canadian Pacific Railway Company (“CP”) suggest that the Canadian experience demonstrates that baseball-type arbitration is not an effective means of resolving railroad-shipper disputes whereas Dow Chemical Company and the Alliance for Rail Competition believe that the Canadian system is a good model for the United States.

³ In *Car Hire Rulemaking*, the ICC approved a mandatory arbitration system administered by the Association of American Railroads (“AAR”) for establishing car hire rates (“Car Hire Arbitration”).

Board and the various parties supporting the Board's proposal in this proceeding to closely examine the significant flaws in Car Hire Arbitration to ensure that those mistakes are not repeated in other arbitration procedures adopted by the Board or legislatively mandated.

RPI and its members are not necessarily opposed to arbitration and agree that mandatory arbitration, at least for certain types of issues, subject to objective disinterested governance and consistent with agency or statutory established standards, can provide a more commercially feasible manner of dispute resolution⁴ and possibly reduce the time and expense of resolving disputes in the railroad industry.⁵ Given the past experience of certain RPI members with Car Hire Arbitration, however, RPI shares many of the concerns raised by the United States Department of Transportation ("DOT") and the AAR.

First, DOT correctly points out that arbitration can be a long, expensive process if not properly structured.⁶ Car Hire Arbitration, as currently structured and administered by the AAR, has unfortunately become such an expensive process, at least for some participants. Under Car Hire Arbitration, the arbitrator is to select the final offer that is closer to the fair market rental value of the cars at issue based on "evidence of comparable arm's-length transactions". In approving the Car Hire Arbitration system, the ICC recognized the importance of having car hire data made available to the parties.⁷ As a result of assurances from the AAR that such data would be made available, the ICC declined to make disclosure mandatory. Because of AAR's self-imposed confidentiality screen, however, few, if any, market rates are being provided by AAR to parties seeking arbitration. Consequently, parties that have negotiated few, if any, rates for a

⁴ Comments of National Grain and Feed Association at 2.

⁵ Comments of NITL at 2.

⁶ Comments of DOT at 1.

particular car type are at a major disadvantage in electing to pursue arbitration with Class I railroads that have numerous negotiated rates readily available in their files. For example, in one recent arbitration, the AAR provided only one market rate to the non-Class I party in arbitration. Ironically, AAR subsequently recanted even on that rate on the grounds that the rate failed AAR's confidentiality screen. In circumstances such as this, the arbitration process is not only patently unfair, but, as DOT suggests, can become extremely expensive. The party with little or no market data (i.e., any non-Class I railroad) is forced to introduce extensive evidence and argument as to why its final offer is more reflective of the true market rate.⁸ In adopting or recommending any additional arbitration procedures, the Board must insure that any relevant evidence needed for arbitration is not uniquely in the hands of one category of parties.

Second, the AAR correctly argues that without substantive standards governing arbitration, the results would not be grounded in the standards and policies of ICCTA. Car Hire Arbitration is a poster child for AAR's concerns in this proceeding. The Car Hire Arbitration system is prone to producing – and has produced – results in conflict with the statutory criteria governing car hire rates. The statutory provision governing car hire rates provides, in pertinent part, that “[t]he rate of compensation to be paid for each type of freight car shall be determined by the expense of owning and maintaining that type of freight car, including a fair return on its cost giving consideration to current costs of capital, repairs, materials, parts, and labor.” 49 U.S.C. § 11122(b). The Car Hire Arbitration system, however, is standardless and, as currently

⁷ *Car Hire Rulemaking*, 9 I.C.C.2d at 91, 1104-05. “[Arbitration] cannot be performed without the proper data, and insufficient market data will make the entire proposal for depreservation unworkable.” *Id.* at 1104.

⁸ By way of analogy, if an arbitration system similar to Car Hire Arbitration were adopted for railroad-shipper rate disputes and parties could introduce contract rates as surrogate evidence of reasonable rates, small shippers in particular, which likely will have few, if any, such contracts

administered, is producing car hire rates that bear no relation to true market rates but rather rates that are contrived for purposes of arbitration or established between affiliated parties.⁹

In *Car Hire Rulemaking*, the ICC specifically stated that car hire disputes in arbitration were subject to Section 11122. By specifying that evidence of arm's-length negotiations be submitted to the arbitrator, the ICC presumably was of the view that such negotiated rates could act as a surrogate for the criteria in Section 11122. As previously noted, in some recent arbitrations, virtually no market data was provided to the non-Class I participant in the arbitration process. The opposing Class I party, in whose economic interest it was to drive the car hire rate at issue as low as possible, presumably had numerous rates available and was able to select the lowest, and not the most prevalent or representative, rates in its files. Class I carriers in the course of recent arbitration proceedings have introduced rates charged by TTX to its owning carriers and rates that were created between two carriers not as a market transaction but for the sole purpose of developing a rate to be used in evidence in an arbitration involving a third party. Consequently, the evidence submitted by the Class I carrier was not of arm's-length transactions and the arbitrator's decision could not possibly have been consistent with the criteria of Section 11122.¹⁰ Accordingly, in any future arbitration procedures adopted by the Board, the

available to them, will be at a distinct disadvantage with the Class I railroads which have hundreds, if not thousands, of contracts readily available in their files.

⁹ The AAR is concerned that standardless arbitration will lead to unpredictability which, in turn, will adversely influence the business decisions by railroads and shippers. Comments of AAR at 10. The Car Hire Arbitration system, however, has produced the opposite result. The outcome of any arbitration between a Class I and a non-Class I is readily predictable: the Class I wins. This, of course, is not the type of consistency RPI's members seek.

¹⁰ CN and CP correctly point out that "[a]ny [arbitration] 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...."

Board should specifically identify the statutory criteria to be utilized by the arbitrator and the type of evidence that is relevant and material to support such a case.

Third, RPI shares AAR's and DOT's concern over finding a sufficient number of arbitrators with expertise in rail transportation. In administering Car Hire Arbitration cases, the AAR uses a panel of arbitrators supplied by the American Arbitration Association. It is not apparent why none of these arbitrators has relevant rail industry experience, but possibly because few such arbitrators without bias to one side or the other exist. In complex areas such as rail freight and car hire rates, the availability of arbitrators with knowledge of the industry is essential.

Fourth, in any future arbitration system adopted by the Board, there should be some reviewability of the arbitrator's decision by the Board. Under Car Hire Arbitration, the arbitrator is expressly precluded from issuing an opinion, comment or statement and the award may be reviewed only under the extremely limited provisions of the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* Consequently, parties arbitrating under Car Hire Arbitration are totally unaware of the extent, if any, to which the arbitrator relied on evidence that is clearly irrelevant to the decisional criteria, such as TTX rates, and whether the arbitrator's decision is consistent with the statutory criteria governing car hire rates.¹¹

Fifth, no assumption should be made that the initial rules governing an arbitration system will be perfect. Flaws in any new system may not be evident until the system is first used. The Board should carefully consider the mechanism intended to evolve the rules of arbitration should

Comments of CN and CP at 8. The Board need look no further than Car Hire Arbitration to confirm CN's and CP's concerns.

¹¹ RPI also agrees with the concerns of Edison Electric Institute concerning the confidential nature of arbitration proceedings and that the lack of transparency skews the playing field in

it become apparent that the process is systemically biased in favor of one class of participant. The Car Hire Arbitration system has a rule making body, a committee of the AAR, consisting primarily of one class of arbitration participants: the Class I railroads. The Car Hire Arbitration system is not evolving through rule change to correct existing deficiencies because the rule makers and those who benefit from the deficiencies are one in the same. This issue can be avoided as long as the process and rules are subject to objective disinterested governance.

In conclusion, RPI respectfully urges the Board to carefully review and take into consideration the fundamental flaws in, and the one-sided nature of, the Car Hire Arbitration system before adopting other mandatory arbitration procedures.

Respectfully submitted,

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Dated: January 3, 2002

favor of the parties that most often engage the arbitration process. Comments of Edison Electric Institute at 2, note 2.