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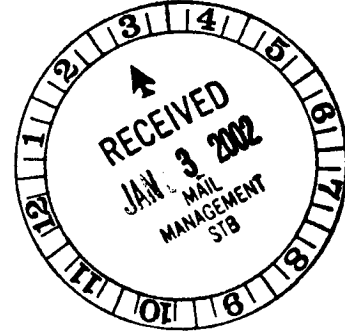
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204268

January 3, 2002



Via HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

RE: **Arbitration—Various Matters Relating to its Use as an Effective
Means of Resolving Disputes that are Subject to the Board's
Jurisdiction—Ex Parte No. 586**

Dear Secretary Williams:

Enclosed for filing in the captioned proceeding, please find an original and ten copies of the Reply Comments of the Association of American Railroads.

Please date-stamp a copy of this pleading and return it to our messenger.

Sincerely,

A handwritten signature in cursive script, appearing to read "Samuel M. Sipe, Jr.".

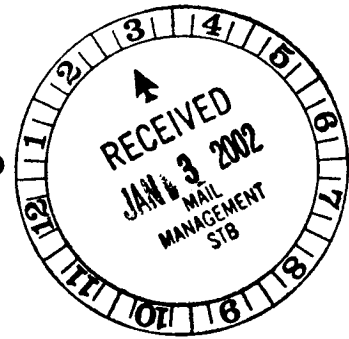
Samuel M. Sipe, Jr.
Counsel for the Association
of American Railroads

Enclosure

cc: Parties of Record

**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**

**REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS**

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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
THAT ARE SUBJECT TO THE BOARD’S JURISDICTION**

**REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS**

The Association of American Railroads (“AAR”) submits these comments on behalf of itself and its individual members in reply to the comments submitted by other parties. AAR adheres to its strongly held view that mandatory arbitration of small rate disputes is not only unnecessary but also would threaten to undermine the statutory scheme that the Board is charged with administering.

The Board received a total of 19 comments in this proceeding. The commenters included large rail shippers, shipper associations, government agencies, and railroads. The comments underscore several points:

- No comments were filed by “smaller rail customers,” the entities whose concerns about the adequacy of Board procedures to address small rail rate disputes prompted the Board to initiate this proceeding.¹ AAR submits that the absence of any such comments suggests that there is no need for new legislation to address rate disputes involving parties “who do not ship a substantial amount of traffic by rail.”²

¹ See September 18, 2001 Decision (September Decision) initiating this proceeding at 3.

² *Id.*

- Several diverse commenters, including notably the U.S. Department of Transportation ("DOT"), address the dangers inherent in proposals to replace the statutory standards that guide Board decisionmaking with the type of standardless, final offer arbitration ("FOA") proposed by other commenters. DOT's emphasis on the importance of retaining the principle of differential pricing by railroads in any decision-making regime is particularly notable, as are the concerns about arbitration voiced by the owner of several shortline railroads.
- The comments of some large shippers and shipper associations in support of new legislation reveal that the agenda of these commenters has less to do with addressing purported concerns of small volume shippers involved in rail rate disputes, and more to do with a broader agenda to change the existing rail regulatory scheme. The thinly-veiled agenda of these groups is to encourage the enactment of legislation that would undermine or eliminate ICCTA standards and reduce or eliminate the role of this Board in adjudications involving virtually all rail/shipper disputes, regardless of the size of the shipper or the nature of the dispute.
- What the FOA-proponents advocate would amount to the effective repeal of statutory policies that recognize the need for railroads to earn sufficient revenues to maintain their systems and attract capital. AAR submits that their proposals go far beyond the scope that the Board defined for this proceeding and constitute unsound public policy.

AAR will address these points in further detail below, and respond as well to some of the specific arguments raised by the commenters. AAR also reiterates its view that if any further steps are needed to address the small rate case concerns that some have raised, the appropriate course would be to adopt a mediation program modeled on that used by the federal courts, as outlined in AAR's initial comments.

I. The Comments Fail to Disclose a Need for the Enactment of New Legislation to Protect Small Shippers

The Board's focus in its September Decision, reiterated in its October 26, 2001 decision denying the petition of the NIT League to broaden this proceeding, has been on developing a record to share with Congress on the narrow question of whether legislation should be enacted adopting mandatory arbitration procedures for small rate disputes, *i.e.*, those involving shippers that tender a limited amount of rail traffic. The Board's stated goal was to

address concerns voiced by Members of Congress and apparently some shippers that existing Board adjudicatory procedures might be too costly or cumbersome for such small volume shippers to pursue a rate dispute with a railroad.

In light of the Board's explicit purpose to address small rate case issues, it merits special note that *no* shippers of modest volumes of rail traffic chose to file comments in support of legislation to address the concerns that prompted the Board to initiate this proceeding. The record, instead, is dominated by comments filed by large rail shippers and by national shipper associations, parties focused on pursuing a broader agenda with respect to rail policy issues. The record contains not a single example of a small rate dispute that a shipper claims it might have brought but did not bring because of the time or expense associated with existing Board procedures. In fact, most of the shippers that support mandatory arbitration procedures do so in the belief that such procedures should not be limited to small rate dispute cases, but rather should be made available to shippers involved either in rate disputes of any magnitude or in a variety of other types of disputes with railroads.³

The absence of any evidence that small volume shippers really need new, non-consensual procedures to resolve rate disputes should lead the Board, and Congress, to conclude that no further consideration of mandatory arbitration is warranted. As AAR observed in its initial comments, any serious consideration with regard to changing the carefully crafted terms

³ For example, the National Grain and Feed Association ("NGFA") states that it sees no reason why mandatory arbitration should be limited to maximum rate cases. NGFA Comments at 12. AAR does not agree that mandatory arbitration should be imposed in any circumstances. In that regard, AAR notes that the NGFA/AAR Agreement to use arbitration for certain types of disputes between NGFA and AAR members is a consensual agreement and not one imposed on the signatories by some third party. That NGFA/AAR Agreement shows that arbitration procedures can work, but only when they are developed and implemented through the mutual consent of the parties, taking into account the concerns of the participants involved.

that Congress adopted only six years ago in the ICC Termination Act of 1995 is premature, given that the Board's existing consensual arbitration procedures and its simplified guidelines for small rate cases have not been used. This is particularly the case where such change would effectively supplant both the Board's role as an expert adjudicatory body and the statutory standards that the Board is empowered to implement, including the statutory directive that the Board "recogniz[e] the policy . . . that rail carriers shall earn adequate revenues . . ." 49 U.S.C. § 10701(d)(2).

II. Parties with Diverse Interests Recognize the Dangers Inherent in Substituting Standardless Arbitration for Board Adjudication

AAR and its member railroads are not alone in arguing that caution is warranted in considering a standardless mandatory arbitration regime for any category of cases that would otherwise be subject to statutory standards and Board adjudication. Diverse parties, representing a variety of different interests, have likewise urged caution and counseled against the expansive use of mandatory arbitration.

The DOT Comments very clearly recognize that any arbitration procedures that might be adopted should be limited to an appropriately narrow class of smaller volume shippers and must embrace standards that recognize the over-arching importance of differential pricing principles as a means of protecting railroad revenue needs.⁴ The following excerpt from page 6 of the Department's Comments merits special emphasis:

The most critical factor for any arbitration process is the requirement for it to acknowledge and take into account the railroad industry's need to engage in differential pricing. This was

⁴ DOT suggests a pilot program of mandatory arbitration limited to a narrowly defined class of small rate disputes. AAR does not agree with DOT that this approach would be useful. Any such process, even on a trial basis, would not reflect truly consensual private sector dispute resolution.

crucial to the success of the Staggers Act and it remains so today. . . .

The importance of this issue cannot be overstated. If the set of "small shippers" eligible for arbitration is eventually defined in an overly expansive manner, they could collectively account for a significant amount of overall railroad revenues. If these shippers are paying rates well above variable costs and arbitration lowers them to the jurisdictional minimum of 180 percent of variable cost, this would reduce rail revenue by several percentage points. The impact on income or cash flow available for reinvestment in these circumstances would be much larger and could either discourage additional railroad investment or actually cause railroads to reduce service. Obviously, the possibility of such an outcome would have to be analyzed and guarded against in any arbitration proposal. (footnote omitted).

AAR fully concurs in DOT's contention that the application of differential pricing principles, which are inherent in the ICTTA statutory standards applied by this Board in rail rate proceedings, would have to be of central importance in any alternative dispute resolution proposal that might be fashioned. Indeed, an expansive application of standardless FOA, and the likely revenue drain that would result, would undermine critical Rail Transportation Policy goals that favor the promotion of a safe and efficient rail network "by allowing carriers to earn adequate revenues, as determined by the Board" and that foster "sound economic conditions in transportation." *See* 49 U.S.C. § 10101(3), (5).⁵

The comments submitted by Edison Electric Institute ("EEI") on behalf of its investor-owned electric utilities also urge caution in approaching the issue of mandatory arbitration. Unlike many commenting shipper groups, EEI, which represents the interests of large coal shippers, recognizes the danger of supplanting the existing regulatory scheme with

⁵ DOT also properly recognizes that statutory provisions applicable to maximum rate regulation, including the need to establish market dominance as a condition to challenging rail rates, must remain within the Board's purview, and that exempt traffic should remain beyond the scope of mandatory arbitration.

mandatory, standardless arbitration. Thus, "EEI would oppose the adoption of ADR procedures if those procedures were required of shippers as a substitute for regulation of railroads that is (or would otherwise be) available under law." EEI Comments at 2. While EEI says that it favors arbitration for small rate disputes, it also states that arbitration is not properly applied in many different types of proceedings and that Board decisionmaking should not be supplanted in any proceeding in which the "public interest" is a relevant or necessary factor. AAR submits that the public interest is at stake in *any* rate dispute regardless of its size. Specifically, there is a public interest in ensuring that any rate reasonableness determination take account of the need for railroad revenue adequacy, as the statute currently requires.⁶

The Genesee & Wyoming Inc. ("G&W") Comments, filed on behalf of several shortlines owned by that company, argue that mandatory arbitration would be harmful to shortline rail interests. G&W observes that changing procedures for challenging rail rates would subject shortlines to more rate challenges and thus greater expense, particularly in connection with larger shippers who might be encouraged to exploit their leverage over small railroads. G&W also takes issues with the notion of standardless arbitration and urges, like AAR, that the options for consensual arbitration provided by the Board's current rules offer a sufficient alternative for addressing the needs of small volume shippers.

Finally, the comments submitted by Canadian National Railway Company ("CN") and Canadian Pacific Railway Company ("CP"), both AAR members, address the problems with FOA based on the Canadian experience with that type of arbitration procedure. These problems, which include cost, complexity, bias in favor of shippers and the lack of decisionmaking tied to a coherent economic regulatory scheme, are discussed further below.

⁶See 49 U.S.C. §§ 10701(d)(2), 10101(3).

III. Large Shippers and National Shipper Associations Seek to Use this Proceeding to Advance Their Private Agendas

A few major rail customers,⁷ together with national shipper associations that have long argued in favor of changing rail regulatory statutes to favor the interests of their shipper members,⁸ argue in favor of the sweeping application of mandatory, standardless arbitration to virtually all rail rate cases and to numerous categories of other types of rail/shipper disputes. For example, the NIT League Comments urge that arbitration be applied at the complainant's option to a wide range of rate disputes, demurrage cases, loss and damage disputes, car and equipment program disputes, including misrouting cases, terminal switching charge cases, claims for failure to provide service on reasonable request, etc. Further, the NIT League would define "small rate cases" so expansively as to embrace a very broad array of rate disputes, while other shipper parties would define small rate cases to embrace large volumes of traffic, *e.g.*, 2,500 carloads per year, or place no size limit at all on a rate case that would be subject to mandatory arbitration.⁹ The NIT League even goes so far as to advocate that arbitrators be empowered to prescribe rail rates for up to two years and to revoke exemptions so that claims of shippers of

⁷ *E.g.*, Dow Chemical Company ("Dow") and PPL Generation LLC ("PPL").

⁸ NIT League, the American Chemistry Council ("ACC"), The Alliance for Rail Competition ("ARC"), The Fertilizer Institute ("Fertilizer"), and the National Grain and Feed Association ("NGFA").

⁹ See NIT League Comments at 4, 16 (supporting arbitration in rate disputes and non-rate disputes respectively); NIT League Comments at 10 (defining "small rate cases"); North Dakota Public Service Commission ("NDPSC") Comments at 5 (defining small rate case as 2500 carloads per year); North Dakota Grain Dealers Association ("NDGDA") Comments at 5 (same); ACC Comments at 2 (setting no limit at all to determine what a small rate case is).

exempt traffic can be arbitrated, thereby authorizing arbitrators to intrude fundamentally on the Board's authority.¹⁰

Widespread use of mandatory arbitration as advocated by NIT League would alter both the statute and the Board's role in implementing it beyond recognition. In effect, ICCTA standards and policies would be nullified, replaced with arbitration results dictated by the preferences of individual arbitrators. The Board's expertise would be supplanted by arbitral decisions that inevitably would lack uniformity, consistency and adherence to standards that draw their essence from the Rail Transportation Policy and the substantive provisions of ICCTA. In effect, economic regulation would be reduced to a game of arbitral roulette.

Some shipper commenters are relatively circumspect regarding the implications of the new procedures that they advocate. They urge that the rail industry should follow the lead of other industries in expanding the use of arbitration, suggesting that the application of arbitration here is just a matter of catching up with the rest of the business world.¹¹ In doing so they ignore fundamental points made by AAR in its initial comments. First, the arbitration of commercial disputes is virtually always consensual. What these shipper interests propose is not consensual, but forced participation in a decisionmaking regime presided over by private arbitrators rather than expert decisionmakers.

Second, the rail industry is unlike most others because it is subject to a public interest-based regulatory regime designed by Congress. That regime protects shippers by providing them the right that is not generally available in other sectors of the economy – to challenge prices alleged to be unreasonably high. That regime is also intended in part to

¹⁰ See NIT League Comments at 6.

¹¹ See NIT League Comments at 3; NGFA Comments at 2.

promote adequate rail revenues by protecting the ability of railroads to engage in differential pricing. The mandatory arbitration regime sought by the shippers would expand shippers' opportunities to challenge rail rates but dispense with the protections for railroads. Several shipper groups also advocate that arbitration should be available at the shipper's option but not the railroad's, further underscoring the lack of evenhandedness in their approach.¹²

Other commenters are more overt in expressing the view that the Board and the regulatory system it administers should be scrapped in favor of standardless arbitration. For example, the paper on FOA submitted by ARC observes that if FOA were adopted in the United States, "the Surface Transportation Board could have an administrative role in the process, or it could be absorbed by either [sic] another entity, thereby giving reason to terminate the Board."¹³

Such expressions unmask the intent of these commenters to replace the existing statutory-based scheme of regulatory adjudication with a mandatory arbitration program that they believe will better serve their interests. Such an arbitration program would in fact likely serve shipper interests to the extent that it would not be constrained by the policies embodied in ICCTA. Eliminating those policies and eliminating or marginalizing the Board's role in applying them is precisely what these parties seek and explains why their comments are not confined to issues involving small rate cases that are supposed to be the focus of this proceeding.

¹² See ACC Comments at 2; ARC Comments at 6; EEI Comments at 1; Fertilizer Comments at 2; PPL Comments at 8; Western Coal Traffic League Comments at 8; Montana Wheat & Barley Committee, et al. Comments at 5.

¹³ See ARC Comments at page 1 of attached paper of Dr. Harvey A. Levine.

Significantly, the FOA-proponents also advocate very limited Federal Arbitration Act review of arbitral decisions by the Board or a court.¹⁴ Their proposals would leave no role for the Board to determine whether substantive statutory ratemaking (or other applicable) standards were properly applied and no opportunity for meaningful Hobbs Act review of the arbitral decision by U.S. Courts of Appeals. If implemented, these proposals regarding review would mean that FOA would result in the effective loss of Board and appellate court precedents that offer guidance to railroads and shippers on the interpretation and application of statutory principles, as well as the loss of consistency and uniformity in the implementation of ICCTA standards. As AAR explained in its initial comments, the consistent application of statutory and regulatory standards by an expert agency is a fundamental hallmark of the Board's role.

IV. Reply to Comments on Certain Specific Issues

In this section of its reply comments, AAR addresses certain specific matters raised in several of the comments.

A. Definition of Small Rate Case

Few parties have endeavored to offer a specific definition of a "small rate case," perhaps a tacit recognition of the fact that there is no easy or obvious way of distinguishing "small" rate disputes from others. Many commenters take no firm position on the number of cars or amount of revenue at issue that would qualify a rate dispute as small rate case.¹⁵ Some commenters suggest that the eligibility standard should be in the vicinity of 100 to 200 cars per year, others propose (as the Board suggested) 200-500 cars per year, while two commenters

¹⁴ See, e.g., NIT League Comments at 13 (proposing review by Board limited to Federal Arbitration Act standards); ARC Comments at 7 (proposing similar review by courts).

¹⁵ See DOT Comments at 5; NIT League comments at 10.

suggest that any movement involving less than 2,500 carloads per year should qualify for small rate case treatment.¹⁶ AAR believes that any definition of a small rate case should be designed to include less traffic rather than more, for the reasons identified by DOT. An overly expansive definition of small rate case carries with it the danger of affecting significant amounts of rail traffic and adversely affecting railroad revenue.

Some commenters argue that a small rate case should be defined in terms of the amount of a shipper's traffic (or associated revenue) generated by movements over a specific origin/destination route, rather than in terms of a shipper's aggregate traffic on a defendant railroad.¹⁷ AAR submits that this "o/d pair" approach is flawed because it fails to take into account the negotiating leverage that a shipper may possess by virtue of its combined shipments over multiple routes of a defendant carrier. The "o/d pair" approach could allow large, sophisticated shippers to recast themselves as small volume shippers eligible for alternative "small rate case" procedures. This result would be inconsistent with the Board's objective of developing simplified procedures for those rail customers "who do not ship a substantial amount of traffic by rail" (September Decision at 3) and would threaten a serious dilution of essential rail revenues due to an overly broad definition of shippers eligible for alternative procedures.¹⁸

¹⁶ See Dow Comments at 6 (100 cars); Fertilizer Comments at 9 (200 cars); Ohio Rail Development Commission Comments at 3 (200-500 cars); NDPSC Comments at 5 (2500 cars); NDGDA comments at 5 (2500 cars).

¹⁷ See NIT League Comments at 10; ARC Comments at 5; Dow Comments at 4; Fertilizer Comments at 7.

¹⁸ See DOT Comments at 6, fn. 4 (describing the significant impact to railroads of a revenue loss of only a few percent and noting that "any expansion of shipper eligibility makes concerns about decreases in rail revenues that much more critical.")

B. Arbitration Procedures/Final Offer Arbitration

Those parties that favor broad-based arbitration also generally favor FOA procedures for rate cases. This approach should be rejected. FOA arbitration is the very embodiment of standardless arbitration and, for reasons already discussed, its use would undermine the statutory and regulatory standards embodied in ICCTA and the Board's precedents.

Shippers espousing FOA point to the Canadian experience with this procedure. But shipper endorsements of the use of FOA procedures in Canada must be viewed in light of the contrary experience of the Canadian railroads, as described in their initial comments. CN and CP have concluded, that FOA "is not an effective means" of resolving shipper/railroad disputes.¹⁹ They observe that that process is more complex and costly than it appears; it is systematically biased in favor of shippers (who can invoke the process at will, making negotiations less productive); and it results in heightened hostility between shippers and railroads. The process leaves ill-trained arbitrators to decide cases "without the support of a coherent and rational economic scheme to assess the appropriateness of each party's final offer."²⁰ CN and CP observe that these same problems would be manifest in any extension of Canada's FOA-style system to this country. They make a more favorable initial assessment of a pilot project on mediation in Canada and, accordingly, support the mediation proposal that AAR has described in its comments.

¹⁹ CN/CP Initial Comments at 4 (emphasis in original).

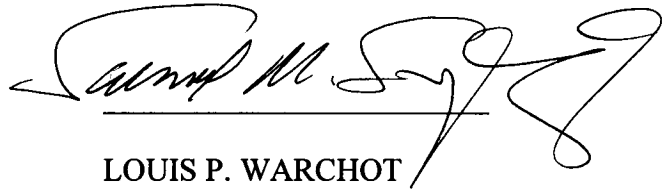
²⁰ Id at 5-6.

V. The Mediation Approach Outlined by AAR Should be Favored

The mediation approach that AAR outlined in its initial comments suffers from none of the flaws of mandatory arbitration. Unlike mandatory arbitration, the mediation procedures that AAR proposes would be truly consensual. Those procedures are based on the successful use of mediation in the federal courts. They offer a relatively simple and low cost means of allowing each party to assess the merits of its own case and that of the opposing party, while offering enhanced opportunities -- under the guidance of experienced Board staff -- for settlement of disputes. Consensual mediation is consistent with the Alternative Dispute Resolution Act and with the approach of other agencies, including DOT. Moreover, and perhaps most importantly, mediation would not sacrifice statutory standards, precedents or the vital role of the Board.

Finally, it bears noting that on November 8, 2001, the Board issued a report on the first year of its Rail Consumer Assistance Program. The Board observed that that consensual program has proven to be "effective in providing a valuable problem-solving service to the rail consumer public." That Program was adopted by the Board to help shippers informally resolve disputes with railroads, and the report indicates that Board staff was successful in doing so with respect to 110 inquiries and complaints, including rate-related matters, submitted to it during the past year. AAR submits that informal and consensual approaches, such as that exemplified by the Rail Consumer Assistance Program and the mediation program that AAR has outlined, are the proper way to approach whatever small volume shipper concerns are not currently being adequately addressed.

Respectfully submitted,



Of Counsel:

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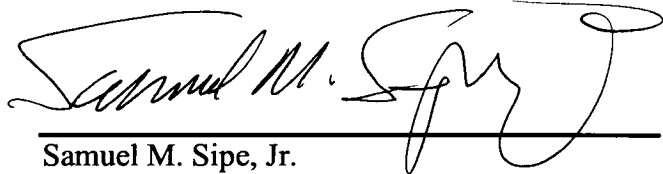
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Counsel for the Association
of American Railroads

Dated: January 3, 2002

Certificate of Service

I certify that I have served a copy of the Reply Comments of the Association of American Railroads by first-class mail, postage prepaid, on all parties who filed Initial Comments in this proceeding.

A handwritten signature in black ink, appearing to read "Samuel M. Sipe, Jr.", written over a horizontal line.

Samuel M. Sipe, Jr.
Counsel for the Association of American
Railroads