



U.S. Department of
Transportation

General Counsel

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Washington, D.C. 20590

204272

January 3, 2002

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001



Re: Ex Parte No. 586

Dear Secretary Williams:

Enclosed herewith are the original and ten copies of the Reply Comments of the United States Department of Transportation in the above-referenced proceeding. There is also a computer diskette of this document, convertible into Word Perfect. I have included as well an additional copy of the Department's comments that I request be date-stamped and returned with the messenger.

Respectfully submitted,

Paul Samuel Smith
Senior Trial Attorney

Enclosures

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Office of the Secretary

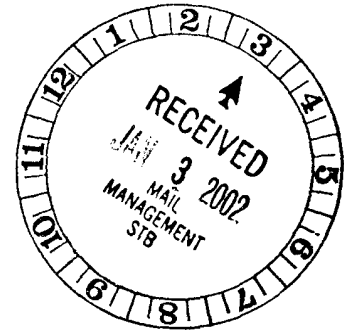
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Before the
Surface Transportation Board
Washington, D.C.



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

Reply Comments of the
United States Department of Transportation

I. Introduction

The Surface Transportation Board ("STB" or "Board") in this proceeding is, *inter alia*, exploring the use of mandatory binding arbitration to resolve disputes about rates between railroads and small shippers.¹ The United States Department of Transportation ("DOT" or "Department") in its initial comments stressed the importance of differential pricing to the rail industry, addressed various issues posed by the Board, and suggested that the Board should consider seeking legislative authority to conduct a pilot program.

DOT's initial comments noted that any proposal for mandatory arbitration of small rail rate disputes presents both threshold and procedural issues. The threshold issues include: the criteria for determining which rail shippers would be included in the class of "small" shippers eligible to invoke mandatory arbitration; the traffic covered (or excluded); the relevance of a rate's revenue-to-variable cost ratio (if any); and the "standards" or guidelines that arbitrators would apply to the facts of each case in rendering awards. The procedural issues include: the minimum qualifications of the arbitrators; the duration of the award; the bases for appeal; the form of arbitration (*i.e.*, final offer or conventional); and whether there should be a written explanation of the decision.

The initial comments of other parties reflect serious differences between railroads and shippers on most of these issues. More importantly, the record assembled to date contains a paucity of hard data and offers little relevant experience on which to base proposals as potentially far-reaching as mandatory arbitration. We therefore repeat our

^{1/} The STB also intended to update information relative to arbitrators and to encourage use of existing alternative dispute resolution procedures.

original recommendation that mandatory binding arbitration should only be utilized at this stage in a carefully-structured pilot project. The experience gained thereby would provide a more sound basis for future action, legislative or regulatory, on the subject of arbitration.

II. Discussion

A. Mandatory arbitration

The railroad industry and shippers are of very different views on this subject. Major U.S. carriers, represented by the Association of American Railroads ("AAR"), strongly oppose mandatory binding arbitration as inconsistent with voluntary resolution of disputes and at least potentially at variance with the principles in the Staggers Act as implemented by the Board and the Interstate Commerce Commission. Comments of AAR at 5, 8-10. Canadian railroads criticize the arbitration program established in that country as "complex, costly, time-consuming ... biased toward shippers" and lacking an appreciation of rail revenue needs. Comments of Canadian National/Canadian Pacific ("CN/CP") at 2. Both carrier groups favor instead a mediation process involving the government. Comments of AAR at 11-16; CN/CP at 9-11. By contrast, virtually without exception shippers and their representatives support mandatory binding arbitration. See, e.g., Comments of The Fertilizer Institute ("TFI") at 1-2; PPL Generation ("PPL") at 2-4; Alliance for Rail Competition ("ARC") at 5-7; National Industrial Transportation League ("NITL") at 4-6; American Chemistry Council ("ACC") at 2-3. They mostly differ in the breadth of the application and the particular details of the program they would prefer.

The Department acknowledges the disagreement between the parties on the basic question of mandatory arbitration. There is nothing contained in the pleadings of the other parties in this regard, however, that causes us to modify our previously expressed views. There can be no dispute that shippers are entitled to statutory protection against unreasonably high rail rates. 49 U.S.C. §§10101(6), 10701(d). Nor can there be disagreement that federal law sanctions the ability of rail carriers to engage in differential pricing, recognizing that such a pricing structure is essential to maintaining the industry's financial stability. 49 U.S.C. §§ 10101(3), 10704(a)(2). DOT's initial comments broadly sought to emphasize that this proceeding should recognize the importance of balancing these two absolutely fundamental principles. Any realistic avenue of relief for small shippers must maintain this balance.

Any proposal for mandatory binding arbitration presents a large number of issues. Among the most critical are the standards or guidelines that arbitrators would apply to the facts of each case in rendering an award, the basis for appeals, and the criteria by which

"small" shippers would be defined. These issues are complicated and to some extent interrelated.²

B. Decisional standards

The Department has stated its view that in any arbitration program it would be crucial that arbitrators have clear standards on which to base decisions that approximate those arrived at through current constrained market pricing procedures. Comments of DOT at 6-7. We also previously expressed the hope that the record in this proceeding would shed some light on such a standard. *Id.* Unfortunately but not surprisingly, to date that has not happened.

AAR supports existing standards. Comments of AAR at 6-9. Shippers, however, take a different view. Some urge an outright prohibition on the submission of stand-alone cost analyses. *See* Comments of TFI at 10; NITL at 12. They view such evidence as "inconsistent with the entire purpose of arbitration as a cost-effective, timely method of resolving smaller rate disputes." Comments of TFI at 10. But this would deny decisionmakers the use of the single existing method for determining rate reasonableness that has analytical validity and judicial approval. NITL argues that any legislation should not establish "rigid standards," but only that a "reasonable" rail rate would need to exceed the jurisdictional threshold. Comments of NITL at 12. Absent clear and consistent standards, however, DOT questions what basis arbitrators would use to reach their decisions.

One party suggested that arbitrators should make awards based simply upon "what is relevant and the credibility of the information provided." Comments of ARC at 7. However, as the Department has already noted, without at least guidance on the issue of differential pricing, such an approach will inevitably lead to pressures to lower rates that may have significant consequences for the financial strength of the rail industry. Comments of DOT at 6. Absent considerably more specific standards, arbitrators faced with a choice between two rate proposals will almost inevitably choose the least "extreme" rate. If shippers propose rates above the 180% jurisdictional threshold, but below the rate offered by the carrier, they will, DOT believes, generally prevail. While this may be a significant temporary boon to the shipper, we remain concerned that ultimately such downward pressure on rates could so lower railroad revenues as to reduce needed investment in railroad infrastructure. Again, a careful balance that weighs the revenue needs of the carrier with the economic position of the shipper is required. To

^{2/} For example, the more narrowly the class of "small" shippers is defined, the fewer the number of cases apt to be brought and (arguably) the less critical the content of decisional standards or guidelines, in the sense that any impact on the rail industry's rate structure would be correspondingly reduced. Conversely, the more numerous the class of "small" shippers, the larger the volume of cases and the greater the implications for the industry rate structure.

date, only the constrained market pricing principles embedded in the stand-alone cost procedure provide such balance.

C. Small shippers

The Department initially expressed a concern that for any mandatory arbitration proposal there would be pressure to expand the definition of a "small" shipper, and that such an expansion would increase the risk to rail industry viability. Comments of DOT at 5-6. Based on a review of the filings thus far, DOT's concerns appear appropriate. A number of parties urged expansion of the definition of small shippers well beyond the range proposed by the Board; Dow Chemical Co. ("Dow") is perhaps the best example. Dow ships an extremely large amount of rail traffic -- more than 98,000 carloads per year. It points out, however, that this traffic moves between a wide variety of origin and destination pairs; 93% of it in the year 2000 moved in traffic lanes (*i.e.*, between different origin and destination pairs) with fewer than 100 carloads a year. Comments of Dow at 4-5. Dow further stresses that "(f)or each traffic lane over which Dow believes its rail rate for a commodity is unreasonable, it must bring separate rate complaints." *Id.* at 5.

The Department acknowledges that it would be very difficult and expensive for Dow to pursue the hundreds of rate cases that would be required if it were to object to every rate. On the other hand, if a shipper as large as Dow is to have access to mandatory arbitration, it would seem that only unit train coal shippers and a few others would continue to be obliged to use existing stand-alone cost procedures. DOT agrees with the STB that higher-volume rail customers should be able to exert "greater pricing leverage" on carriers and should be excluded from mandatory arbitration. NPRM at 5. Although Dow may have little leverage for each of its individual shipments, it clearly has leverage in negotiating comprehensive contract rates with the railroads.

DOT notes that a number of parties suggested a variety of standards by which to identify "small" shippers, including revenues, carload numbers, amount of reparations at issue and various combinations. *See* Comments of National Grain and Feed Association ("NGFA") at 4-6, 9; Ohio Rail Development Commission at 3; TFI at 6-8; Dow at 4-6. We recognize the justifiable desire on the part of shippers for a more effective method of challenging rail rates. However, we continue to believe that expanding the focus of eligibility for mandatory arbitration from small shippers to "small shipments," as Dow and others do, simply resurrects concerns regarding rail industry revenue losses sufficient to reduce infrastructure investment. Unfortunately, none of the filings provided information that would support a particular level of traffic or shipper revenue, or indicated the change in the volume of carloads that would be at risk if a particular suggestion was adopted. This uncertainty counsels in favor of a pilot program rather than a permanent one, since we clearly do not have enough evidence or experience at this time concerning how the program would work in the long run.

D. Small railroads

The Genessee & Wyoming, Inc. ("GW") filing raised a number of issues that warrant serious consideration. As this party notes, many smaller railroads do not use accounting systems that permit the use of the Uniform Railroad Costing System ("URCS"), which makes it impossible to determine revenue-to variable-cost percentages -- a pivotal limitation on the STB's jurisdiction. Comments of GW at 4-5. Requiring small railroads to adopt this system might be an expensive and unnecessary burden and should be undertaken only after careful consideration, perhaps on a case-by-case basis.

It should also be noted that a "small shipper" to a Class I railroad may be a very large shipper to a small railroad. If adequate standards are not in place to guide arbitrators, decisions that result in lower rates for a single shipper could leave a small railroad with seriously reduced revenues. The Department accordingly urges the STB to give further consideration to the issue of mandatory binding arbitration as applied to small rail carriers. There are no doubt small shippers on short lines who believe they are paying unreasonable rates. However, an arbitration procedure with grave consequences for railroad revenue requirements is no less unwise because the railroad in a given case is small.

E. Arbitration of other issues

Carriers and shippers have disagreements on a wide variety of issues other than rates, including service, car supply, and per diem charges. A number of parties proposed extending mandatory arbitration to these areas. See Comments of ARC at 6; ACC at 2-3; NITL at 2-4. DOT notes that NGFA and AAR have reached voluntary agreement to use mandatory arbitration to resolve some of these. NGFA Comments at 2-3. We encourage continued efforts of this sort and urge other shipper groups and railroads to explore the possibility of similar agreements. It must also be noted, however, that some of these issues differ significantly from rate disagreements in that arbitrators are able to develop fair resolutions much more easily than is possible with respect to rates. DOT is not prepared to support so broad an expansion of mandatory arbitration without additional evidence regarding the possible impacts from such extension. NGFA even has doubts about the ability of mandatory arbitration to reduce the burden of pursuing rate cases to a level that would enable small shippers to engage in that process. *Id.* at 11.

F. Other

Most parties agreed with DOT that arbitration should be available only to those whose rates are within the Board's (revenue-to-variable cost) jurisdiction and who could otherwise meet the market dominance test. See, e.g., Comments of NITL at 5-6; TFI at 3-4, 10; NGFA at 4, 6-7, 11; CN/CP at 6; Dow at 3.³

^{3/} Those who mentioned the subject also thought that traffic exempt from regulation should remain that way unless the exemption were removed for the shipment(s) in question by the arbitrator pursuant to STB standards. See, e.g., Comments of NITL at 5-6. DOT agrees.

Shippers also shared the Department's view that appeals from arbitrators' decisions should be limited to the bases traditionally allowed under federal law. *See, e.g.*, Comments of NITL at 13; Dow at 8; ARC at 7. *Contra*, Comments of AAR at 6.⁴

G. Pilot program

For the reasons discussed previously and elaborated upon herein, DOT repeats its support for a measured effort to gain experience with mandatory binding arbitration via a pilot program. As we argued in our initial comments, the Department believes that a pilot program to test the effectiveness and the impacts of mandatory arbitration is an appropriate way to build experience with this type of alternative dispute resolution process. A well-designed pilot project would allow the Board to determine the feasibility and practicality of this approach.⁵

III. Conclusion

It is clear that established procures to resolve rail rate disputes are expensive and time-consuming, and that there is a need for an alternative procedure for small shippers. The Department concludes from its review of the initial comments, however, that much more data and analysis are necessary before there is a sufficient record developed to recommend that Congress enact legislation authorizing mandatory arbitration of small shipper rate disputes. Indeed, in many ways the comments, rather than answering the questions posed by the STB, raise additional considerations, for example the impact on short line railroads and expansion of arbitration to non-rate issues. Therefore, the Department supports a limited demonstration project as a means of developing a substantive record for possible consideration of long-term mandatory binding arbitration.

Respectfully submitted,



KIRK K. VAN TINE
General Counsel

^{4/} Those who mentioned the subject also thought that traffic exempt from regulation should remain that way unless the exemption were removed for the shipment(s) in question by the arbitrator pursuant to STB standards. *See, e.g.*, Comments of NITL at 5-6. DOT agrees.

^{5/} DOT must make it clear that, at this time, we are not offering specific guidance on how the program should be designed. We believe that, if authority is granted for a pilot mandatory arbitration program, the Board must have an additional proceeding to develop applicable standards and procedures.