

# Ensuring Due Process at the Surface Transportation Board

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### Other Views:

- Jerry Ellig, *STB's Market Dominance and Final Offer Rate Review*, GW Regulatory Studies Center (Nov. 6, 2019), <https://regulatorystudies.columbian.gwu.edu/stbs-market-dominance-and-final-offer-rate-review> (public interest comment on STB's proposed rules).
- Randy Gordon, *STB launches rulemakings to reform rail rate challenge process*, NATIONAL GRAIN & FEED ASSOCIATION (Sept. 13, 2019), <https://www.ngfa.org/newsletter/stb-launches-rulemakings-to-reform-rail-rate-challenge-process/> (newsletter from National Grain and Feed Association announcing new STB NPRM).
- Rate Reform Task Force, *Report to the Surface Transportation Board* (Apr. 25, 2019), <https://prod.stb.gov/wp-content/uploads/Rate-Reform-Task-Force-Report-April-2019.pdf> (report recommending changes to STB regulations to increase shippers' bargaining power relative to railroads without jeopardizing railroad revenue adequacy).

Starting at the turn of the last century, the United States began to experiment with the concept of "public utility" regulation. The bargain went something like this: in exchange for a government-sanctioned monopoly, the "public utility" would have to provide service at rates set by the government on a non-discriminatory basis. Over the years, enlightened minds realized that even a little competition better serves consumers than does bureaucracy. An era of deregulatory activity ensued. Industries once thought inapt for competition (e.g., telecommunications and airlines) now enjoy significant rivalry. Prices were surrendered to the market and quality improved.<sup>1</sup>

Yet despite this deregulatory progress, there remain a few pockets of American industry where traditional public utility price regulation is still required by federal statute. Given the resources required to hold a formal rate case, several regulatory agencies have sought ways to streamline the process, both for the regulated and the regulator alike. Although such streamlining efforts are laudable in concept, overzealous efforts threaten the constitutional due process rights guaranteed to regulated firms under the Fifth Amendment in the name of regulatory reform.<sup>2</sup> And when the government affirmatively curtails due process, we need to sound (and heed) the alarm bells.<sup>3</sup>

Take, for instance, the Surface Transportation Board's ("STB") recent *Notice of Proposed Rulemaking* to streamline the process used to formulate price regulation of freight rail carriers.<sup>4</sup> Despite good intentions, the STB's proposed rules raise a host of troubling due process concerns. To understand why, this article first presents a brief overview of basic ratemaking principles. Next, it looks specifically at an assortment of provisions contained in the STB's NPRM and highlights how such proposed rules violate these basic ratemaking principles. Conclusions and policy recommendations are at the end.

1 See, e.g., *Orloff v. FCC*, 352 F.3d 415, 420 (D.C. Cir. 2003), cert. denied, 542 U.S. 937 (2004) (Once a service has been de-tariffed, "[r]ates are determined by the market, not the [government], as are the level of profits.").

2 According to the Fifth Amendment to the U.S. Constitution, "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

3 *C.f.*, *Association of American Railroads v. United States Department of Transportation*, 821 F.3d 19 (D.C. Cir. 2016).

4 *Expanding Access to Rate Relief: Final Offer Rate Review*, NOTICE OF PROPOSED RULEMAKING, Docket No. EP 755, Docket No. EP 665 (Sub-No. 2), Surface Transportation Board (Decided: September 11, 2019), available at [https://www.stb.gov/decisions/ReadingRoom.nsf/UNID/1D5C55A4466E4E4785258473004DC82D/\\$file/47104.pdf](https://www.stb.gov/decisions/ReadingRoom.nsf/UNID/1D5C55A4466E4E4785258473004DC82D/$file/47104.pdf), 84 FED. REG. 48872 (published September 17, 2019).



among other things.<sup>18</sup> Once again, notwithstanding the effort, only a few cases were ever brought before the STB.<sup>19</sup>

Apparently, the STB wants to regulate rates. Dissatisfied with the low turnout of rate challenges against freight rail carriers, the STB decided to find out why. After review, shippers informed the STB that there were two root causes: (1) the litigation costs required to bring a case under the Board's existing rate reasonableness methodologies exceeded the value of the case (especially for smaller cases); and (2) the Board's current options did not permit an expeditious resolution.<sup>20</sup>

To encourage more rate challenges, in September 2019 the STB released an *NPRM* to institute a new process called *Final Offer Rate Review*. Loosely basing this process on the arbitration regime used in Canada, the STB is proposing a form of "baseball-style" arbitration upon the freight rail industry. Put simply, this scheme requires the complainant and the defense to submit a proposed rate and the STB to choose one without modification and without an administrative hearing. The STB proposed this novel regulatory approach despite recognizing that the agency "may not require arbitration of rate disputes under current law."<sup>21</sup> To get around the statute, the STB argued that its proposal is technically not a formal arbitration because "the Board would make the determination of rate reasonableness" rather than a third-party arbiter.<sup>22</sup>

The proposed *Final Offer Rate Review* paradigm is comprised of four steps. First, as required by statute, the STB must determine whether the defendant rail carrier has market dominance over the transportation to which the rate applies.<sup>23</sup> As is standard, absent evidence of market dominance, there is no justification for government intervention into the pricing decisions of firms.<sup>24</sup>

Second, following discovery, parties would simultaneously submit their Final Offers, including an analysis addressing the reasonableness of the challenged rate and support for the rate in the party's offer. Each party's Final Offer is supposed to reflect what it considers to be the maximum reasonable rate. Each party submitting an offer has the liberty to choose how to present and support its offer, including the methodology it uses to determine the rate.<sup>25</sup>

Third, after receipt of the Final Offers, the STB would then choose between the competing offers using a variety of factors, including "appropriate economic principles." As with the STB's other rate reasonableness procedures, the agency stated that would "consider" the defendant railroad's need for differential pricing to permit it to collect adequate revenues as mandated by statute.<sup>26</sup> Still, according to the *NPRM*, the STB's choice between competing filings "would be an 'either/or' selection, with no modifications by the Board."<sup>27</sup> In the STB's view, its proposed "approach would work as intended only if the parties know that the agency would not attempt to find a compromise position. The incentives created by a final offer selection procedure could not be preserved if the Board retained the discretion to formulate its own 'offer.'"<sup>28</sup>

Fourth and finally, if the STB finds that the defendant carrier has market dominance, finds the challenged rate unreasonable, and chooses the complainant's offer (or the defendant's offer, if it is below the challenged rate), then the *NPRM* provides that the STB could award relief based on the difference between the challenged rate and the rate in that offer.<sup>29</sup>

### III. DUE PROCESS CONCERNS RAISED BY THE STB'S *NPRM*

Given the basic principles of ratemaking described above, the due process concerns raised by the STB's *Final Offer Rate Review* *NPRM* are readily apparent. For illustrative purposes, a few egregious examples are highlighted below.

Let's start with process. Under the Administrative Procedure Act ("APA"), a complainant bears the burden of proof.<sup>30</sup> Yet by requiring a freight rail operator to present its own best Final Offer, the STB is inappropriately shifting the burden away from the complainant and onto the carrier. The STB cannot set this important due process requirement aside by reducing the ratemaking process to a binary choice between two independently produced Final Offers.

Also, federal law makes clear that the STB may prescribe a maximum rate only after a "full hearing."<sup>31</sup> Given the nature of baseball-style arbitration, the STB's proposed *Final Offer* rules thus raises an obvious question: how can the STB have a "full hearing" when it is faced with only a binary choice between two independently produced "Final Offers"? The short answer: it can't.

This requirement for a "full hearing" is more than just a procedural nuisance to be side-stepped. The scheme proposed by the STB raises the real risk that it could accept a Final Offer which produces a confiscatory rate in violation of the Fifth Amendment. Plainly, a shipper has the incentive to propose the lowest rate possible and may choose its methodology accordingly. So, let's assume arguendo that a shipper is particularly zealous and proposes a rate which borders on (if not constitutes) a price that is confiscatory. Under the plain terms of the STB's proposed

18 See Rate Regulation Reforms, EP 715 (STB served July 18, 2013), remanded in part sub nom. CSX Transp., Inc. v. STB, 754 F.3d 1056 (D.C. Cir. 2014).

19 *NPRM*, *supra* note 4, at 3.

20 *Id.* As to this later point—and with no small bit of lost irony—the STB argued that speed is important because market-based negotiated contract rates may not be challenged before the STB and, as such, "some complainants shift from contract rates to tariff rates before bringing a rate case" even though "tariff rates may be higher than prior contract rates." *Id.* at 3-4.

21 *Id.* at 5.

22 *Id.* (emphasis in original).

23 See 49 U.S.C. § 10707(c).

24 See generally A.E. KAHN, THE ECONOMICS OF REGULATION (1970); W.K. VISCUSI, J.M. VERNON, & J.E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST (1995).

25 *NPRM*, *supra* note 4, at 10.

26 *Id.* at 11.

27 *Id.* at 13.

28 *Id.* (citations omitted).

29 *Id.* at 14.

30 *Id.* at 12 (citing 5 U.S.C. § 556(d)).

31 See 49 U.S.C. § 10704(a)(a).

Final Offer mechanism, the lack of a “full hearing” means that a freight rail operator has no ability to challenge the shipper’s proposed rate directly; its recourse is limited only to presenting its own “Final Offer” (which the STB is free to accept or reject) and then challenging the STB’s decision in court.

Which brings us to the issue of ratemaking methodology (or lack thereof). Under the explicit language of the *NPRM*, the STB permits the “parties to submit final offers using their preferred methodologies, including revised versions of the Board’s existing rate review methodologies or new methodologies altogether.”<sup>32</sup> But as noted above, due process requires an administrative agency to articulate the methodology it intends to use to evaluate the reasonableness of a rate *prior* to any adjudication. The STB apparently believes that it is not bound by this fundamental requirement. The STB’s refusal to commit to a single ratemaking methodology prior to adjudicating a dispute is therefore a *prima facie* case of arbitrary and capricious decision-making.<sup>33</sup>

The STB also apparently believes that skirting due process by permitting parties to choose their own (and possibly widely inconsistent) ratemaking methodologies will “allow for innovation with respect to rate review methodologies” and create “precedent through an adversarial process.”<sup>34</sup> What adversarial process? The STB is choosing between two offers. And by the *NPRM*’s own terms, each individual arbitration stands on the two respective offers provided based on the particular facts—and individual choice of ratemaking methodology—of each case. Thus, the STB’s proposal cannot develop precedent; it inherently evades precedent.<sup>35</sup>

Finally, the STB pays only lip service to a key element of modern railroad price regulation—the concept of “revenue adequacy.”<sup>36</sup> After regulating the rail industry nearly to death, Congress began to formulate a statutory response to the financial woes of the industry with the Railroad Revitalization and

Regulatory Reform Act of 1976. This legislative effort culminated in the Staggers Act, the purpose of which was to “provide for the restoration, maintenance, and improvement of the physical facilities and financial stability of the rail system in the United States.”<sup>37</sup> To curtail regulatory excess, the Staggers Act formally established that regulatory activity must “allow[] rail carriers to earn adequate revenues” as a national policy.<sup>38</sup>

The required shackles on the regulator dictated by the Staggers Act proved somewhat effective. Each year, the STB is required by statute to “determine which rail carriers are earning adequate revenues,” a decision based on a comparison of the return on investments to an estimate of the cost of capital.<sup>39</sup> In recent years, nearly four decades since the Staggers Act was enacted, some firms in the rail industry still struggle to earn a competitive return on their investments. Only since 2012 has the industry *average* return on investment consistently met the STB’s estimate of the cost of capital. But some rail companies do not meet revenue adequacy—a deficit verified annually by the STB itself—and the situation appears tenuous for those railroads that do.<sup>40</sup>

A casual regard for revenue adequacy and a return to aggressive rate regulation poses risks. Empirical research demonstrates that there are significant, causal relationships between the financial health of the rail industry and its investment behavior.<sup>41</sup> The industry has recovered to some semblance of health in the post-Staggers world. An attempt to minimize the statutory policy to respect industry health by imposing a form of baseball-style arbitration represents a serious dereliction of duty at the STB.

#### IV. CONCLUSION

When Congress dictates that an administrative agency should set the rates, terms, and conditions of service of a private firm, the ratemaking provisions contained in an agency’s enabling statute are not solely designed to govern the conduct of the regulated firm (the agency’s rules serve that function), but also to govern the conduct of the *regulator*.<sup>42</sup> Unfortunately, the STB has a long history of not fully understanding this basic concept,<sup>43</sup> and the proposed *Final Offer Rate Review* NPRM suggests little has changed. Rather than prioritize the financial health of the industry, which is uncertain by the STB’s own analysis, the agency

32 *NPRM*, *supra* note 4, at 11.

33 *Fox Television*, 567 U.S. at 253 (A regulation must be capable of sufficiently predictable application “so that those enforcing the law do not act in an arbitrary or discriminatory way.”); *cf.*, Executive Order on Regulatory Relief to Support Economic Recovery (May 19, 2020) at Section 6(i), available at <https://www.whitehouse.gov/presidential-actions/executive-order-regulatory-relief-support-economic-recovery> (“Administrative enforcement should be free of unfair surprise.”).

34 *NPRM*, *supra* note 4, at 11.

35 *C.f.*, T.R. Beard, G.S. Ford, L.J. Spiwak, & M.L. Stern, *Regulating, Joint Bargaining, and the Demise of Precedent*, MANAGERIAL AND DECISION ECONOMICS (27 June 2018); *see also* Direct Marketing Association v. Brohl, 814 F.3d 1129 (10th Cir.), *cert. denied*, 137 S. Ct. 591 (2016) (Gorsuch, J.) (Agencies must “attach power to precedent” so that due process does not “surrender[] similarly situated persons to widely different fates at the hands of unrestrained” bureaucrats.).

36 *NPRM*, *supra* note 4, at 10-11 (“the Board would take into account the policy “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail,” the policy “to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital,” and the policy “to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Board.”).

37 Section 3, Staggers Rail Act of 1980, Pub. L. 96-448 (October 14, 1980), 49 U.S.C. § 10101a (note).

38 49 U.S.C. § 10101a(3).

39 *See* 49 U.S.C. § 10704(a)(3).

40 The annual reports are available at <https://www.stb.gov/decisions/readingroom.nsf/WebServiceDate:openform>.

41 G.S. Ford, *Infrastructure Investment in the Railroad Industry: An Econometric Analysis*, PHOENIX CENTER POLICY PERSPECTIVE NO. 19-07 (December 9, 2019), available at <https://www.phoenix-center.org/perspectives/Perspective19-07Final.pdf>.

42 *See* Spiwak, *USTelecom and its Aftermath*, *supra* note 12.

43 *Supra* note 14.

devotes its attention to ways in which to return to an aggressive regulatory agenda—history be damned.

Regulatory “streamlining” may have benefits. Improving administrative efficiency does not, however, permit an agency to render moot the due process protections guaranteed to the firms it regulates. Before the STB enacts its *Final Offer Rate Review* paradigm into law, a more careful legal analysis of its efforts is required. Contrary to the STB’s current thinking, the Constitution may not be swept under the rug.

