Nos. 22-3648 & 23-1325

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

UNION PACIFIC RAILROAD COMPANY, *Petitioner*,

v.

SURFACE TRANSPORTATION BOARD;
UNITED STATES OF AMERICA, *Respondents*,
AMERICAN CHEMISTRY COUNCIL, et al., *Intervening Respondents*.

ASSOCIATION OF AMERICAN RAILROADS, *Petitioner*,

v.

SURFACE TRANSPORTATION BOARD;
UNITED STATES OF AMERICA, *Respondents*.

On Petitions For Review Of A Final Rule Of The Surface Transportation Board

PETITIONERS' JOINT OPENING BRIEF

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SUMMARY OF THE CASE

Congress vested the Surface Transportation Board with authority to resolve disputes over the rates that freight railroads charge shippers and, in some circumstances, to prescribe the maximum permissible rate. In the final rule challenged here, the Board announced that for certain disputes it will decide cases by conducting a baseball arbitration—that is, by using the same technique arbitrators use to determine the salaries of Major League Baseball players.

The idea behind "Final Offer Rate Review" is that each side makes an offer and the Board, rather than independently determining the legally correct outcome as a judge or agency adjudicator normally does, chooses one of the two offers based on a methodology the Board will not announce in advance.

The Board adopted the rule by a 3-2 vote over strong dissents from two Board Members. The dissenters had it right: The Board lacks statutory authority to implement this extraordinary scheme; the Board's approach is unconstitutionally vague because parties lack fair notice of the methodology the Board will use to decide cases; and its final rule is arbitrary and capricious in many respects.

The Court should allow 20 minutes of argument per side. This is a consolidated proceeding involving all major North American freight railroads and the United States, and is of great importance to the public and the industry. Oral argument will assist the Court in resolving the substantial questions presented.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Petitioners make the following disclosure:

Union Pacific Railroad Company (petitioner in No. 22-3648) is a wholly owned subsidiary of Union Pacific Corporation, a publicly traded company. Union Pacific Corporation is not aware that any publicly traded corporation owns 10 percent or more of its stock. (Union Pacific's understanding and belief is that The Vanguard Group, which is not a publicly traded corporation, as of December 31, 2022 beneficially owned approximately 8.8% of Union Pacific Corporation's stock on behalf of its clients.)

The Association of American Railroads (petitioner in No. 23-1325) is a trade association. It brings this action on behalf of its freight railroad members that are affected by the regulation challenged in this case. The Association of American Railroads has no parent company and is a nonstock corporation.

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PRELIMINARY STATEMENT

For well over a century, Congress has entrusted the Interstate Commerce Commission—now the Surface Transportation Board—with the power to resolve rate disputes between freight railroads and shippers. The Board has the authority to review the reasonableness of the rates that freight railroads charge shippers and, when warranted, to prescribe the maximum rate that a railroad may charge. To guide the Board in this endeavor, Congress enacted a host of statutory factors the Board must consider in order to render a precise, finely-tuned rate prescription that advances the specified economic goals and public policy objectives.

These petitions for review challenge a final rule of the Board announcing that, going forward, it would resolve certain rate disputes and prescribe maximum rates by conducting a baseball arbitration—that is, it would adopt the process used by arbitrators to determine the salaries of Major League Baseball players.

Under "Final Offer Rate Review"—or "FORR"—the Board will abandon its century-old practice of bringing its independent judgment to bear in evaluating the statutory factors, weighing the public policy interests at stake, and specifying the maximum rate permitted under the law. Instead, the railroad and the shipper will each give the Board an "offer" in the form of their proposed rate, and the Board will accept the offer that comes the closest to what, in the Board's view, would otherwise have been the legally correct result.

In the preamble to the final rule, the Board explained that it will not disclose in advance the methodology it will use to assess reasonableness and prescribe the maximum rate. Nor will it commit to using as its rule of decision one of the recognized rate-assessment methodologies that have been upheld by the federal circuit courts. Rather, the litigants will be encouraged to design and create new methodologies of their own—and the Board will reveal the winning methodology when it announces its decision.

The Board appeared to acknowledge that it was straying far from the traditional model of agency decisionmaking when it touted FORR as "an innovative attempt to incorporate a final offer procedure into an agency adjudication." App. 181. The Board adopted FORR by a 3-2 vote, over two dissents that criticized the Board for abdicating its role as an independent adjudicator and for plunging regulated parties into a sea of uncertainty by refusing to reveal in advance the legal standard the Board will use to determine whether they have acted unlawfully.

This Court should grant the petitions for review and vacate the final rule.

First, FORR is not authorized by—and in fact conflicts with—the statutes authorizing the Board to engage in rate-setting. Congress did not give the Board authority to prescribe railroad rates using baseball-arbitration techniques, thereby confining its potential range of decisional outcomes to the two offers submitted by the parties. Rather, Congress authorized the Board to use its independent expert

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judgment to fix with precision the maximum rate in light of the many statutory factors and public-policy considerations Congress established to guide the Board's determination. FORR also conflicts with the statutory requirement that parties be afforded a "full hearing" before the Board may prescribe a maximum rate—that is, a hearing before an adjudicator that exercises its own independent judgment and has not announced in advance that it will only render decisions that have been proposed by one of the parties. And FORR—which resolves rate disputes using what is indisputably an arbitration technique—circumvents what the Board itself concedes is its lack of statutory authority to resolve rate cases through mandatory arbitration.

Second, FORR is unconstitutionally vague and does not provide regulated parties with fair notice of how to conform their conduct to the law. A regulation must inform "regulated parties . . . what is required of them so they may act accordingly," *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012), yet here the Board will not announce in advance the methodology it will use to assess the lawfulness of the railroads' conduct. Regulated parties will not know the legal standard by which they will be judged—it could be through a historic rate-assessment methodology or through a standard newly minted by one's opponent for use in the particular case—until the Board announces its decision. While the Board's choose-your-own-adventure approach may add excitement and unpredictability to the rate-setting process, it is not an approach faithful to constitutional principles of

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fair notice. Nor is it faithful to the Board's statutory duty to maintain simplified "methods" for determining the reasonableness of rates. A scheme that expressly *rejects* adopting any particular method cannot possibly be deemed a method itself.

Third, the final rule is arbitrary and capricious for additional reasons. By adopting FORR, the Board has disabled itself from complying with the Administrative Procedure Act's requirement that agencies engage in "reasoned decisionmaking." Moreover, the Board departed from its own precedent without explanation when it allowed shippers to obtain up to $4 million in relief per case. And the Board simply failed to recognize that FORR is unduly coercive because railroads and shippers do not face reciprocal risks.

Final Offer Rate Review is an ill-advised scheme that violates the governing statutes, the Administrative Procedure Act, and the Constitution. This Court should vacate the final rule.

STATEMENT OF JURISDICTION

The Surface Transportation Board issued a decision adopting the final rule on December 19, 2022. App. 183. Union Pacific filed its petition on December 27, 2022. Doc. No. 5230620. The Association of American Railroads (AAR) filed its petition on January 18, 2023. Doc. No. 5246886. The petition filed by AAR was transferred to this Court from the U.S. Court of Appeals for the D.C. Circuit on February 16, 2023 pursuant to 28 U.S.C. § 2112. Doc. No. 5246866. This Court

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has jurisdiction to review the final rule pursuant to 28 U.S.C. § 2321(a) and 28 U.S.C. §§ 2342–2344. Venue is proper under 28 U.S.C. § 2343 because petitioner Union Pacific Railroad Company maintains its principal place of business in Nebraska. Both petitions are timely under 28 U.S.C. § 2344 because they were filed within 60 days of issuance of the final rule.

STATEMENT OF THE ISSUES

I. Whether the Surface Transportation Board has statutory authority to adopt Final Offer Rate Review.

--49 U.S.C. § 10701

--49 U.S.C. § 10704

--49 U.S.C. § 10707

--*Stone v. U.S. Forest Serv.*, 2004 WL 1631321 (D. Or. July 16, 2004)

--*Morgan v. United States*, 304 U.S. 1 (1938)

II. Whether Final Offer Rate Review is unconstitutionally vague because it fails to provide the fair notice necessary for parties to conform their conduct to the law.

--*FCC v. Fox Television Stations, Inc.*, 567 U.S. 239 (2012)

--*Gentile v. State Bar of Nev.*, 501 U.S. 1030 (1991)

--*Freeman United Coal Mining Co. v. Fed. Mine Safety & Health Rev. Comm'n*, 108 F.3d 358 (D.C. Cir. 1997)

III. Whether Final Offer Rate Review is arbitrary and capricious.

--*Judulang v. Holder*, 565 U.S. 42 (2011)

--*Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983)

--*Encino Motorcars, LLC v. Navarro*, 579 U.S. 211 (2016)

STATEMENT OF THE CASE

1. The Board's Duty To Decide Rate Disputes.

Congress created the Surface Transportation Board in 1995, replacing the Interstate Commerce Commission. *See* ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803. Congress charged the Board with resolving rate disputes between freight railroads and shippers when rates are not set by private contract. *See* 49 U.S.C. §§ 10704(a)(1), 10709(c)(1).

The Board's statutory authority to decide rate disputes requires the Board to first find that the carrier has market dominance and, if so, whether the charged rate is reasonable. *See* 49 U.S.C. § 10701(d)(1) ("If the Board determines . . . that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable."); *id.* § 10707(c) ("When the Board finds in any proceeding that a rail carrier proposing or defending a rate for transportation has market dominance over

the transportation to which the rate applies, it may then determine that rate to be unreasonable if it exceeds a reasonable maximum for that transportation.").

In assessing the reasonableness of a challenged rate, the Board must "give due consideration" to three factors: "the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic"; "the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic"; and "the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues." 49 U.S.C. § 10701(d)(2). In addition, the Board must be guided by the congressionally-defined Rail Transportation Policy, which sets forth numerous additional goals and objectives. *Id*. § 10101. And the Board must "recogniz[e] the policy of this part that rail carriers shall earn adequate revenues." *Id*. § 10701(d)(2).

The Board has the statutory authority to "prescribe the maximum rate" following a "full hearing" if it determines that a railroad with market dominance has charged a rate that exceeds a reasonable maximum for that transportation. Under 49 U.S.C. § 10704(a)(1), "[w]hen the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does

or will violate [Part A, Subtitle IV of Title 49], the Board may prescribe the maximum rate, classification, rule, or practice to be followed."

The Board historically has exercised its authority to judge the reasonableness of a challenged rate—and, if the challenged rate is found unlawful, to prescribe the maximum reasonable rate—by attempting to replicate market outcomes after a full hearing that gives due consideration to a host of statutorily-required factors. *See Coal Rate Guidelines – Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). One element of this approach is the Stand-Alone Cost constraint, which aims to protect shippers from bearing costs of inefficiencies and from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of the carrier's traffic base. *Id*. at 542–46. A Stand-Alone Cost analysis does this by simulating the competitive rate that would exist in a market that is free from barriers to entry. *Id*. at 528.

Because a Stand-Alone Cost analysis can be complicated, Congress has authorized the Board to establish "simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3). The Board has adopted several simplified methodologies for determining reasonableness. A Three-Benchmark analysis determines the reasonableness of the

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challenged rate using three benchmark figures, each expressed as a relationship between revenues and variable costs; and a Simplified-Stand-Alone Cost test focuses on whether a shipper served by only one railroad is forced to cross-subsidize other parts of the railroad's network. *See Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007), *aff'd sub nom. CSX Transp., Inc. v. Surface Transp. Bd.*, 568 F.3d 236, *vacated in part*, 584 F.3d 1076 (D.C. Cir. 2009).

2. The Board's Adoption Of Final Offer Rate Review.

The Board proposed FORR in a Notice of Proposed Rulemaking on September 12, 2019, App. 9, 84 Fed. Reg. 48872 (Sept. 17, 2019), followed by a Supplemental Notice of Proposed Rulemaking on November 12, 2021, App. 98, 86 Fed. Reg. 67622 (Nov. 26, 2021), that made minor changes to the original proposal. By a 3-2 vote, the Board adopted FORR through a final rule on December 19, 2022. App. 168, 88 Fed. Reg. 299 (Jan. 4. 2023).

The Board describes FORR as "a new procedure for challenging the reasonableness of railroad rates in smaller cases." App. 168. Under FORR, the Board will not apply its established rate reasonableness tests and will not independently determine the maximum reasonable rate. Rather, "the Board will decide a case by selecting either the complainant's or the defendant's final offer," *id.*—a procedure best known for its use in salary arbitrations for Major League Baseball players.

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FORR cases must be litigated and decided under "an expedited procedural schedule that adheres to firm deadlines." App. 168. Following a 21-day discovery period, "[p]arties would simultaneously submit their market dominance presentations, final offers, analyses addressing the reasonableness of the challenged rate and support for the rate in the party's offer, and explanations of the methodologies used and how they comply with the decisional criteria set forth in the *NPRM*," including "the [Rail Transportation Policy], the Long-Cannon factors in 49 U.S.C. 10701(d)(2), and appropriate economic principles." App. 171.

The shipper would need to demonstrate that "(i) the defendant carrier has market dominance over the transportation to which the rate applies, and (ii) the challenged rate is unreasonable. If the Board were to find that the complainant's market dominance presentation and rate reasonableness analysis demonstrate that the defendant carrier has market dominance over the transportation to which the rate applies and that the challenged rate is unreasonable, the Board would then choose between the parties' final offers." App. 171 (citations omitted).

The Board will not announce in advance the methodology it will use in determining reasonableness, or in deciding between the final offers. Rather, the parties are free to "choose" their own preferred methodology they would like the Board to apply: They may use "revised versions of the Board's existing rate review methodologies or new methodologies altogether." App. 13. Although it has not

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pledged to do so, the Board's apparent intent is to announce the winning methodology when it announces its decision.

Two of the five Board members dissented, explaining that the final rule is contrary to law and should not have been adopted. Board Member Fuchs stated:

> FORR is an evasion of the Board's fundamental responsibility because it makes the Board entirely dependent on litigants' self-determined rate review methodologies, gives little meaningful guidance for those methodologies, and prohibits the Board from devising its own remedy where necessary.

App. 183. In his view, given FORR's "deep and irreparable flaws," the final rule "could have significant negative consequences for the rail network" by "affect[ing] rail rates nationwide, potentially impacting infrastructure and operations." App. 184. Rejecting the Board's attempt to analogize FORR to its other rate-reasonableness processes, Board Member Fuchs concluded that "FORR is unique among the agency's processes in that the Board evades responsibility on *both* the front and back ends—neither defining methodologies in advance nor permitting the Board's own remedies in individual cases." App. 183.

Board Member Schultz also dissented. She expressed her "deep legal and practical concerns about FORR, which . . . prevents the Board from engaging in reasoned decision-making, fails to properly align risk between complainants and defendants, and could depress rail rates below what is reasonable." App. 185. She explained that "the Board's congressionally authorized responsibility to provide

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regulatory oversight of rates requires more than a reliance upon two submitted proposals. It requires the Board to actually exercise its discretion and decision-making authority." App. 186.

3. The Board Simultaneously Adopts An Arbitration Program.

The same day the Board issued its final rule adopting FORR, it issued another final rule adopting a "voluntary" arbitration program through which railroads and shippers could resolve small rate disputes through arbitration. *See* EP 765, *Joint Petition for Rulemaking to Establish a Voluntary Arbitration Program for Small Rate Disputes*, 88 Fed. Reg. 700 (Jan. 4, 2023). The two rulemakings, although not consolidated, were "considered in parallel." App. 169.

In the arbitration rule, the Board provided that railroads needed to declare by February 23, 2023, whether they were willing to participate in the arbitration program. 88 Fed. Reg. at 730. The Board stated that "to incentivize railroad participation in the arbitration program, the Board will allow carriers to be exempt from rate challenges under the FORR process during their participation in the arbitration program." *Id.* at 702. However, "for the arbitration program to become operable," the Board will "require[] that all Class I carriers agree to participate" in the program. *Id*. "If all Class I carriers agree, the Board will issue a notice that commences the new arbitration program, allowing it to be used and initiating the FORR exemption." *Id.*; App. 171 ("the Board will allow carriers to be exempt from

rates challenges under the FORR process if all Class I carriers join the arbitration program"). On the other hand, "[i]f not all Class I carriers participate, the Board will not issue the notice commencing the new arbitration program, resulting in the program being inoperable, and all Class I carriers will be subject to rate challenges under the FORR process." 88 Fed. Reg. at 702.

On February 23, 2023, the majority of Class I carriers advised the Board that they were *not* willing to participate in the arbitration program. Many railroads pointed to serious flaws in the Board's proposal that would encourage excessive litigation and threaten the health of the rail industry. As a result, FORR became effective as to all carriers on March 6, 2023. *See* App. 168.

SUMMARY OF ARGUMENT

This Court should vacate the final rule because it exceeds and conflicts with the Board's statutory authority, it is unconstitutionally vague, and it is arbitrary and capricious.

I. Congress did not authorize the Board to prescribe railroad rates through a baseball arbitration scheme. FORR exceeds, and conflicts with, the rate-setting statutes because by confining the potential outcomes to the two proposals offered by the parties, it prevents the Board from exercising its own independent judgment and properly evaluating the many factors Congress directed it to consider when rate-setting. Many of these factors reflect the strong public interests in rate regulation,

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yet the Board cannot give due consideration to the public interest when it simply chooses between two "offers" crafted by parties with their own private economic interests. FORR also conflicts with the statutory requirement that parties be afforded a "full hearing" before the Board may prescribe a maximum rate. And FORR exceeds the Board's authority in another respect: As the Board admits, it lacks statutory authority to prescribe rates through mandatory arbitration. FORR—which even the Board acknowledges is an arbitration technique—is a brazen attempt to circumvent that conceded lack of statutory authority.

II. FORR is unconstitutionally vague. The Board intends to decide FORR cases and determine the lawfulness of the railroads' conduct based on a standard that the agency will not disclose in advance. A regulation must inform "regulated parties . . . what is required of them so they may act accordingly," *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012), yet railroads have no way of knowing in advance what the Board might deem an unreasonable rate, or even what evidence might be relevant to the Board's decision, because they do not know how the Board will determine what is "reasonable" in any given case. The Board's refusal to establish a governing methodology in advance, or to provide any ascertainable standard for how it will make reasonableness determinations, deprives railroads of the constitutionally-mandated fair notice necessary to conform their conduct to the law. Moreover, FORR is not a permissible exercise of the Board's authority to

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maintain simplified "methods" for determining the reasonableness of rates. Not only is FORR not a "method," it expressly *rejects* adopting a method for assessing rate reasonableness.

III. The final rule adopting FORR is arbitrary and capricious for additional reasons. FORR prevents the Board from engaging in reasoned decisionmaking because it prohibits the Board from choosing the correct outcome, unless one of the parties just happens to propose it. In addition, by allowing shippers to obtain up to $4 million in relief per FORR case, the Board departed without explanation from longstanding agency precedent. And the Board simply failed to acknowledge that FORR will exert undue coercive pressure on the railroads because the risks that a railroad and a shipper will face in a FORR proceeding are not reciprocal.

ARGUMENT

The Board describes FORR as "an innovative attempt to incorporate a final offer procedure into an agency adjudication." App. 181. FORR may or may not be innovative, but it is plainly unlawful and unconstitutional. This Court should vacate the final rule.

I. Final Offer Rate Review Exceeds, And Conflicts With, The Board's Statutory Authority.

"Administrative agencies are creatures of statute [and] possess only the authority that Congress has provided." *Nat'l Fed'n of Indep. Bus. v. OSHA*, 142 S. Ct. 661, 665 (2022) (per curiam). For that reason, under the Administrative

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Procedure Act, a court must vacate a final rule when the agency has acted "in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2)(C); *Union Pac. R.R. Co. v. Surface Transp. Bd.*, 863 F.3d 816, 822 (8th Cir. 2017) (stating that "[a]gency action taken without statutory authority must be set aside" and vacating Board rule as exceeding its statutory authority). "It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988). The Board, like all other federal agencies, "has no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress." *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001). "An agency's promulgation of rules without valid statutory authority implicates core notions of the separation of powers, and [courts] are required by Congress to set [such] regulations aside." *United States ex rel. O'Keefe v. McDonnell Douglas Corp.*, 132 F.3d 1252, 1257 (8th Cir. 1998).

The Board is wrong in claiming that it has statutory authority to adopt FORR. Congress has not authorized the Board to prescribe shipping rates using a baseball arbitration scheme. In fact, FORR *conflicts* with the governing statutes in key respects: It prevents the Board from exercising independent judgment and giving full consideration to the full panoply of statutory factors and public-interest considerations that Congress established to guide the Board in prescribing rates; it

denies parties the "full hearing" that Congress required before the Board could prescribe a rate; and it circumvents the Board's lack of authority to prescribe rates through mandatory arbitration. This Court should therefore vacate the final rule as "in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2)(C).

A. FORR Prevents The Board From Exercising Its Own Independent Judgment In Light Of The Statutory Factors And Public Policies That Guide Rate-Setting.

The Board claimed that 49 U.S.C. § 10704(a)(1) provided the statutory authority for adopting FORR. *See* App. 172 & n.18. That statute provides:

> When the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does or will violate [Part A, Subtitle IV of Title 49], the Board may prescribe the maximum rate, classification, rule, or practice to be followed.

49 U.S.C. § 10704(a)(1). Part A in turn provides that if a rail carrier has market dominance, its charged rate must be "reasonable." *Id.* § 10701(d)(1). Congress specified a list of factors and objectives the Board must take into account when assessing reasonableness and prescribing a maximum rate. *See id.* § 10701(d)(2); *see also id.* §§ 10101(3), 10704(a)(2).

1. Final-offer decisionmaking is an alternative dispute resolution technique. It is not a permissible way for the Board to perform its statutory duty of prescribing a maximum rate. Congress intended that the Board would use its own independent judgment and expertise in deciding the correct outcome as required

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under the governing law. Congress did not intend that the Board would merely decide which party has proposed a result that comes *closest* to the correct outcome.

The animating principle underlying the administrative state is that complex regulatory decisions are properly assigned to agency experts who "have unique expertise, often of a scientific or technical nature," *Kisor v. Wilkie*, 139 S. Ct. 2400, 2413 (2019) (quotation marks omitted), and can bring to bear their informed and independent judgment to solve the nation's most challenging regulatory issues. When Congress entrusted the Board with prescribing the maximum rates railroads may charge shippers in certain cases, it expected the agency would do so by exercising its own informed and independent judgment. Congress wanted experts, not baseball arbitrators, at the helm of the administrative state.

The Supreme Court has emphasized this exact point, explaining:

> The process of rate making is essentially empiric. The stuff of the process is fluid and changing—the resultant of factors that must be valued as well as weighed. Congress has therefore delegated the enforcement of transportation policy to a permanent expert body and has charged it with the duty of being responsive to the dynamic character of transportation problems.

Board of Trade of Kansas City v. United States, 314 U.S. 534, 546 (1942). It follows that in a rate-setting case, "[a]ny solution ha[s] to rest on informed judgment" by the Interstate Commerce Commission (now replaced by the Board), "as illumined by the seasoned wisdom of the expert body" tasked with making "difficult judgments of

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economic and transportation policy." *Id*. at 547–48. Under FORR, however, the Board will *not* be applying its own "informed judgment" in prescribing a maximum rate; rather, it will be doing nothing more than choosing which of the parties' two proposals most closely approximates the result the Board would have selected if it *had* exercised its own informed judgment.

In some cases, the maximum rate—that is, the rate that best achieves the many objectives the Board is statutorily required to consider—may be above (or below) the parties' final offers. In other cases, the maximum rate may fall between the final offers. Yet "FORR would require the Board to choose between two rates" even where "the Board finds the correct outcome falls above, below, or somewhere in between the two submissions." App. 185 (Schultz dissenting). A scheme that forces the Board to choose something other than "the correct outcome," *id*., conflicts with the statute and is not authorized by Congress.

"[T]he Board is the expert body Congress has designated to weigh the many factors at issue when assessing whether a rate is just and reasonable." *BNSF Ry. Co. v. Surface Transp. Bd.*, 526 F.3d 770, 774 (D.C. Cir. 2008) (Kavanaugh, J.). By adopting FORR, however, the Board has disabled itself from properly considering the host of statutory factors Congress directed it to consider when resolving rate disputes and prescribing maximum rates. Congress directed the Board to give "due consideration" to "the amount of traffic which is transported at revenues which do

not contribute to going concern value and the efforts made to minimize such traffic"; "the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic"; and "the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues." 49 U.S.C. § 10701(d)(2). The Board's rate determinations must also take into account the many objectives reflected in the nation's Rail Transportation Policy, including that rail carriers "earn adequate revenues." *Id.* § 10101(3); *see also id.* § 10704(a)(2) (requiring the Board to make "an adequate and continuing effort" to ensure adequate revenues when judging the reasonableness of rates).

The Board cannot give "due consideration," 49 U.S.C. § 10701(d)(2), to every one of the above factors if it is limited to the two outcomes proposed by the parties. The variety of factors Congress directed the Board to take into account requires the Board to achieve a reasonable precision in independently choosing the rate itself, rather than simply selecting whichever one of the parties' proposals happens to be closer to what in the Board's view is the actual maximum.

2. By confining its decisional options to the final offers proposed by the railroad and shipper, the Board violates its statutory mandate in another respect: It cannot properly take the public interest into account.

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The Board's statutory rate-setting responsibility goes beyond simply resolving discrete disputes between private parties. Rather, the Board is charged with implementing public policies established by Congress that have broad implications for public welfare. *See, e.g.*, 49 U.S.C. § 10101 (setting forth 15 discrete considerations to implement the nation's "Rail transportation policy," including the need "to ensure the development and continuation of a sound rail transportation system . . . to meet the needs of the public and the national defense"); *see also id*. § 10701(d)(2) (Board must give "due consideration" to overall "mix of rail traffic" when prescribing rates). If rates are set too high, shippers will not supply enough goods to satisfy demand. If rates are set too low, railroads will be subsidizing inefficient production and consumption.

In adjudicating rate cases, the Board's role is not "simply to act as an umpire, calling balls and strikes for the adversaries appearing before [the agency]." *Pub. Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & Santa Fe Ry. Co.*, NOR 42057, slip op. at 3 (STB Jan. 19, 2005), *pet. for review denied sub nom. BNSF Ry. Co. v. Surface Transp. Bd.*, 453 F.3d 473 (D.C. Cir. 2006). The Board is "not intended to be a passive arbiter but the guardian of the public interest, with a duty to see that this interest is at all times effectively protected." *Id*. at 4 (quoting H.R. Doc. No. 678, Practices and Procedures of Governmental Control of Transportation, 78th Cong., 2d Sess., at 53 (1944)) (cleaned up). Thus, the Board cannot be "the prisoner

of the parties' submissions, but rather ha[s] the duty to 'weigh alternatives and make its choice according to its judgment of how best to achieve and advance the goals of the National Transportation Policy.'" *Id*. (quoting *Balt. & Ohio R.R. Co. v. United States*, 386 U.S. 372, 429 (1967) (Brennan, J., concurring)); *see also Ass'n Am. R.R. v. Surface Transp. Bd.*, 237 F.3d 676, 681 (D.C. Cir. 2001) ("The national transportation policy for railroads, 49 U.S.C. § 10101, is to guide the [Board] in applying the rail provisions of the Interstate Commerce Act.") (cleaned up). In short, when the Board sits as an adjudicator of rate cases, "the right of the public must receive active and affirmative protection." *Harlem Valley Transp. Ass'n v. Stafford*, 500 F.2d 328, 335 (2d Cir. 1974).

Unlike deciding the salary of a baseball player, prescribing a maximum rate for rail traffic has a broad public impact that affects many stakeholders beyond the two disputing parties. Yet the Board cannot give due consideration to the public interest if it is simply choosing between the "final offers" crafted by litigants with their own private economic interests. As Board Member Schultz explained, "[i]t is this limitation on the Board's ability to exercise its own judgment by weighing each side's arguments, evaluating the evidence, and considering both the public interest and rail transportation policy that I find to be so troubling." App. 185.

Final-offer decisionmaking is not a permissible way for the Board to perform what the Supreme Court has described as the "legislative function" of prescribing

rates. *Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co*., 284 U.S. 370, 389 (1932). In light of the broad public interest at stake in rate-setting proceedings—an interest that extends well beyond the two parties to the dispute—this Court has held that the Board's "ratemaking function . . . most closely resembles an informal rulemaking procedure under the Administrative Procedure Act," *Burlington N., Inc. v. United States*, 549 F.2d 83, 88 (8th Cir. 1977), and has described "[r]ate prescription" as "a product of informal rule-making." *Burlington N., Inc. v. United States*, 555 F.2d 637, 640 (8th Cir. 1977); *see also* 5 U.S.C. § 551(4) (defining a "rule" as "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy . . . and includes the approval or prescription for the future of rates"). Just as it would be inconceivable for an agency to conduct a rulemaking through a baseball-arbitration scheme, the Board cannot perform its legislative function of prescribing rates through final-offer decisionmaking.

3. In the preambles to the original and supplemental notices of proposed rulemaking, as well as in the final rule itself, the Board attempted to defend its claim that it had statutory authority to resolve cases using FORR. *See* App. 9, App. 98, App. 168. Those efforts fall short.

The Board denies that it has "abandon[ed] its statutory duty to apply the law in determining, based on its own best judgment, the maximum reasonable rate."

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App. 104 (quotation marks omitted). The Board states that "adjudicators routinely rely on or adopt the parties' submissions or decisional framework." App. 104. Of course they do; that is why parties file legal briefs, in hopes that the adjudicator will be persuaded by, and adopt, their views. But what adjudicators do *not* do is bind themselves, by regulation, to adopting the views of one of the parties—even in cases where the adjudicator himself concludes the law requires a result other than the ones the parties proposed. As the D.C. Circuit stated in a dispute between BNSF and the ICC, "no adjudicator would expect to be able to rely entirely on one side's analysis." *Burlington N. R.R. Co. v. ICC*, 985 F.2d 589, 599 (D.C. Cir. 1993). The Board argues that "nothing in [*BNSF v. ICC*] stands for the proposition that the Board may not accept one party's proffered rate where it finds it superior to the rate offered by the other party." App. 104. But no one is arguing that the Board cannot accept one of the parties' proffered rate; the point is that the Board cannot abdicate its statutory duty to prescribe the maximum reasonable rate by *confining* its decisional outcomes to the parties' offers.

Congress intended that the Board would bring its expertise to bear, and render its own independent judgment—informed but not controlled by the parties' submissions—in prescribing the maximum permissible rate. By denying that it is obligated to "perform[ ] a rate analysis distinct from any party's pleadings," App. 173, and by asserting that it can discharge its statutory duty merely by choosing the

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offer that comes closest to what the Board in its own judgment would deem the maximum permissible rate, the Board disclaims the role of independent adjudicator. Although the Board asserts that "[t]he simple fact is that the Board's exercise of discretion to offer FORR would not constrain its authority to prescribe a maximum rate under section 10704(a)(1)," App. 103, that is clearly wrong. By adopting FORR, the Board would be constraining its rate-setting authority by limiting itself to the two outcomes proposed by the parties.

The Board attacks a straw man in saying that critics "assume[ ] that a maximum reasonable rate exists in the abstract, outside of any Board process used to determine the maximum reasonable rate." App. 173. The point is that in every case there would be a maximum rate that the Board would have chosen on its own, if it had not constrained its outcomes to the parties' offers. As Board Member Fuchs explained, "working within the binary selection process that FORR imposes, in some cases the Board cannot even select obvious, superior solutions." App. 184.

The court rejected an agency's attempt to use final-offer decisionmaking in *Stone v. U.S. Forest Service*, 2004 WL 1631321 (D. Or. July 16, 2004), holding that the agency lacked statutory authorization to adopt the procedure. In that case, the statute at issue required the Forest Service to make a fair market valuation of land in a protected area. The agency obtained two appraisals (one arranged by the property owner, the other by the agency) and adopted "a 'baseball-arbitration'-style

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procedure, in which the decisionmaker simply chooses between the two [valuations], even though the actual fair market value may be somewhere in between those two values." *Id*. at *3. The court stated:

> I find nothing in the applicable statutes that condones the procedures utilized by the agency here . . . . The agency ostensibly sought to calculate the fair market value of Plaintiffs' property. "Baseball-style arbitration" is not a procedure well-tailored to that end. The [statute] does not command the agency to select the "better" of the two appraisals. Perhaps neither appraisal is on the mark, and fair market value is somewhere in between.

Id. at *7. The same logic applies here. There is nothing in the applicable statutes that condones FORR, which is not a procedure well-tailored to determining the maximum rate a railroad may charge.

The Board's attempt to distinguish *Stone* falls short. The Board says that in *Stone*, the agency was required to conduct appraisals in conformity with certain appraisal standards, App. 173, but here too the Board is required to assess the reasonableness of the charged rate, and prescribe the maximum rate, in conformity with a host of standards and considerations, *see* 49 U.S.C. § 10701(d)(2). The Board next says that, unlike the appraisal in *Stone*, the Board's determination of a maximum rate "is not the kind that can be assessed for accuracy with reference to the external world." App. 173. That is clearly wrong. Among other things, in prescribing the maximum rate, the Board must ensure that the carrier "shall earn adequate revenues," 49 U.S.C. § 10701(d)(2)—a determination that *must* be made

with reference to "the external world." Finally, the Board suggests that *Stone* turned on the risk the government would simply choose its own appraisal without fairly considering the landowner's, App. 173, but the court's conclusion made abundantly clear that the flaw in the agency's scheme was the lack of statutory authorization for the agency to resolve disputes through baseball-style arbitration. *See Stone,* 2004 WL 1631321, at *7. Just as Congress did not authorize the Department of Agriculture to resolve disputes through a baseball-style arbitration technique, it has not authorized the Board to do so.

4. Final Offer Rate Review conflicts with the governing statute in yet another respect: it does not give parties the full hearing using judicial standards that the statute and due process require. *See* 49 U.S.C. § 10704(a)(1) (Board may prescribe maximum rates only after a "full hearing").

A full hearing requires an adjudicator that has retained its full decisionmaking powers, not one that has tied its hands by artificially limiting its decisional range to two possibilities. As the Supreme Court has explained, "Congress, in requiring a 'full hearing,' had regard to judicial standards—not in any technical sense but with respect to those fundamental requirements of fairness which are of the essence of due process in a proceeding of a judicial nature." *Morgan v. United States*, 304 U.S. 1, 19 (1938).

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It would be an egregious violation of "judicial standards," *Morgan*, 304 U.S. at 19, for a judge, before he even received a complaint, to publicly announce that to streamline proceedings in his courtroom, he would decide all cases through baseball-style arbitration, limiting himself to issuing orders that were proposed by whichever party came closest to what he deemed the legally correct outcome. Just as a judge cannot adopt a decisional methodology that rejects fundamental elements of a trial—*e.g.*, refusing to assess credibility by announcing in advance that all witness testimony will be deemed credible—the Board cannot announce in advance that it will confine its decisional outcomes to the parties' two proposals. It is inherent in the nature of a "full hearing" that the adjudicator will render their own judgment as to the legally correct outcome, rather than artificially limit their decisional range to the two outcomes proposed by the parties. Because FORR denies parties a full hearing, it is contrary to statutory authority.

The Board notes that Congress authorized it to develop expedited procedures for deciding rate cases. But Congress was quite clear that in doing so, the Board must look to procedures used <u>by courts</u>. The STB Reauthorization Act provides:

> (c) PROCEDURES.—Not later than 180 days after the date of the enactment of this Act, the Surface Transportation Board shall initiate a proceeding to assess <u>procedures that are available to parties in litigation before courts</u> to expedite such litigation and the potential application of any such procedures to rate cases.

Surface Transportation Board Reauthorization Act of 2015, Pub. L. No. 114-110, § 11(c), 129 Stat. 2228, 2234 (emphasis added). Because final-offer techniques are not used in "litigation before courts," they are not a permissible way for the Board to resolve rate disputes. The Board also notes that under 49 U.S.C. § 10701(d)(3), it is authorized to "maintain 1 or more simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which a full [Stand-Alone Cost] presentation is too costly, given the value of the case." App. 169 (emphasis omitted). But the quoted authority is limited to "methods for determining the reasonableness of challenged rates;" it does not extend to prescribing the maximum rate, which happens only once the carrier has been found to have market dominance and the challenged rate has been found unreasonable.

B. The Board Lacks Statutory Authority To Prescribe Rates Through Mandatory Arbitration.

FORR exceeds the Board's statutory authority in another respect. It uses an arbitration technique to resolve disputes even though the Board acknowledges that it "may not require arbitration of rate disputes under current law." App. 170; *see also Arbitration—Various Matters*, EP 586, slip op. at 3 n.7 (STB Sept. 20, 2001) (Board "cannot mandate arbitration under the current statute"). The final rule notes that the idea of FORR originated in a report by the Board's own Rate Reform Task Force. *See* App. 168. The task force touted the purported benefits of a final-offer scheme, but conceded the Board's lack of statutory authority and therefore could

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only "recommend legislation that would permit the Board to require arbitration of small rate disputes." *See* Rate Reform Task Force, *Report to the Surface Transportation Board* at 12 (Apr. 25, 2019), https://www.stb.gov/wp-content/uploads/Rate-Reform-Task-Force-Report-April-2019.pdf.

FORR is an impermissible attempt to circumvent the Board's lack of statutory authority to require arbitration of rate disputes. Final-offer review is not a decisionmaking approach that agencies use in adjudications. Rather, it is an *arbitration* technique that arbitrators use to force settlements—as evidenced by the Board's failure to identify any other agency that uses a final-offer review scheme outside the arbitral context. *See* App. 102 n.22. The Board's own authorities, App. 170, make clear that FORR is a coercive, settlement-forcing arbitration technique that is ill-suited for the Board's legislative task of rate-setting. *See* Michael Carrell & Richard Bales, *Considering Final Offer Arbitration to Resolve Public Sector Impasses in Times of Concession Bargaining*, 28 Ohio St. J. on Disp. Resol. 1, 1 (2012) (final offer arbitration is "an ADR method that guarantees a settlement"); Josh Chetwynd, *Play Ball? An Analysis of Final-Offer Arbitration, Its Use in Major League Baseball and Its Potential Applicability to European Football Wage and Transfer Disputes*, 20 Marq. Sports L. Rev. 109, 109 (2009) (describing final-offer decisionmaking as a "form of arbitration" that "spurs negotiated settlement at a very high rate"). Even the report the Board cites to support the rulemaking (App. 170)

proposes final-offer decisionmaking as part of an "arbitration procedure"—*not* something the Board would adopt for its own use. *See* Nat'l Acads. of Scis., Eng'g & Med., *Modernizing Freight Rail Regulation*, at 211–12 (2015). Congress's refusal to allow the Board to require arbitration of rate disputes is further evidence that it has not allowed the Board to resolve rate disputes using an arbitration technique.

The Board's efforts to identify comparable schemes falls short. Although the Board claims that it "already uses a final offer procedure as part of the Three-Benchmark methodology," App. 170, in Three-Benchmark, the final offer procedure is but one component of the overall methodology; it does not provide the very framework for decision. As the Board concedes, even in Three-Benchmark, the final-offer component "is only one part of the rate reasonableness approach as opposed to providing the overall framework, as the Board is adopting here." App. 170. Likewise, the Board errs in citing its "Maximum Markup Methodology"—one component of a Stand-Alone Cost analysis—as an example of a discretion-limiting procedure. App. 172. "Maximum Markup" is not a final-offer procedure, and any limitation on the Board's discretion pales in comparison to FORR's extreme constraint limiting the Board to two outcomes.

The Board's reliance on the Canadian process for resolving rate disputes through final-offer arbitration is similarly misplaced. App. 170 & n.12. Not only are there fundamental differences between the U.S. and Canadian legal systems that

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prevent importing a Canadian-style approach here, but Canada has enacted a statute expressly *authorizing* final-offer arbitration. *See* App. 170 n.12. Congress, of course, has not enacted a similar statute. Finally, the Board notes that through the AAR car-hire rules, car owners and users can utilize final-offer arbitration in the negotiated car-hire rate process. App. 170. But that is a mechanism for two private parties to voluntarily resolve a dispute in a deregulated area; they agree to submit their dispute and agree to be bound by the arbitrator's decision. That is very different from an agency forcing an arbitration process on unwilling parties.

II. Final Offer Rate Review Is Unconstitutionally Vague.

The Board's scheme suffers from another fatal defect: FORR does not give parties the fair notice necessary to conform their conduct to the law. The Board will determine whether a railroad's challenged rate is unlawful based on a methodology that it will not disclose in advance. A central feature of FORR is that the parties are free to create and propose their own methodologies for the Board's consideration—and the Board will then reveal the winning methodology when it decides the case. Board Member Fuchs explained that because "FORR requires litigants to create their own methodology and reasoning," it will create "particularly acute uncertainty" among regulated parties. App. 184–85. That is an understatement. Parties will have *no idea* what standard the Board will use to determine the lawfulness of their conduct and will therefore be unable to conform their conduct to the law. This renders FORR

unconstitutional under the Due Process Clause. And while Congress authorized the Board to maintain "simplified and expedited *methods* for determining the reasonableness of challenged rates" in smaller cases, 49 U.S.C. § 10701(d)(3) (emphasis added), FORR is indisputably not a "method." For these reasons, the court should vacate the final rule as contrary to law, 5 U.S.C. § 706(2)(A), and in excess of the Board's statutory authority, *id.* § 706(2)(C).

A. FORR Fails To Provide Regulated Parties With Fair Notice Of What The Law Requires.

1. Before the Board can exercise its rate-prescribing authority, it must make the threshold determination that the railroad's charged rate is unreasonable. *See* 49 U.S.C. § 10704(a)(1) ("When the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does or will violate [Part A, Subtitle IV of Title 49], the Board may prescribe the maximum rate, classification, rule, or practice to be followed."). Yet the Board refuses to identify the methodology it will use to assess whether the charged rate is unreasonable. As the Board admits, "FORR does not prescribe a particular methodology" the Board will use in determining reasonableness. App. 15. Rather, parties may propose that the Board "us[e] their preferred methodologies, including revised versions of the Board's existing rate review methodologies or new methodologies altogether." App. 13. Only when the Board announces its decision

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in the case will it reveal the methodology it chose to determine whether the railroad's conduct was unlawful.

A regulation must inform "regulated parties . . . what is required of them so they may act accordingly." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012). "A regulation is unconstitutionally vague if it fails to give a person of ordinary intelligence a reasonable opportunity to know what is prohibited." *Thomas v. Hinson*, 74 F.3d 888, 889 (8th Cir. 1996). In the context of business regulation, "regulations will be found to satisfy due process so long as they are sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve, would have fair warning of what the regulations require." *Freeman United Coal Mining Co. v. Fed. Mine Safety & Health Rev. Comm'n*, 108 F.3d 358, 362 (D.C. Cir. 1997); *see also Nat'l Indus. Constructors, Inc. v. Occupational Safety & Health Rev. Comm'n*, 583 F.2d 1048, 1054 (8th Cir. 1978) ("In determining whether an administrative regulation provides adequate notice, courts have inquired whether [a company] familiar with the circumstances of the industry could reasonably be expected to have had adequate warning of the conduct required by the regulation.").

Under FORR, regulated parties will not know in advance how to conform their conduct to the demands of the law. FORR provides "no principle for determining" when a challenged rate passes "from the safe harbor" of the permitted "to the

forbidden sea" of the prohibited. *Gentile v. State Bar of Nev.*, 501 U.S. 1030, 1048–49 (1991). In determining the rate to charge a shipper, a railroad cannot know in advance what the Board might deem unreasonable, because it does not know the methodology the Board will use to determine "reasonableness" in any given case. Even the Board will not know in advance what methodology will be used to decide the case because it will rely on the parties to supply the methodology. A shipper could use any one of the Board's existing methodologies, or the shipper could use a brand new methodology it crafted for use in the particular dispute. Indeed, if the Board is correct that shippers view existing methodologies as too expensive and cumbersome for resolving smaller disputes, then it is virtually certain that a shipper invoking FORR will develop its own methodology and urge the Board to adopt it. The shipper could even develop the methodology that will determine the lawfulness of the railroad's conduct *after* the conduct in question occurred.

Even once a complaint proceeding has begun, railroads will not know what evidence the Board might deem relevant until it is too late. Indeed, given that the Board will not disclose in advance the methodology it will use to decide the case, there is no way railroads could know with certainty the evidence the Board might ultimately deem relevant. Railroads will be put to the untenable choice of producing vast amounts of confidential information out of an abundance of caution, or running

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the risk that the Board will later deem some of that information to have been relevant and rule against them.

The Board may view all of this vagueness and uncertainty as facilitating compromise, but the Due Process Clause does not permit the Board "to classify arbitrariness as a virtue," *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 59 (1991) (O'Connor, J., dissenting), and the vagueness that permeates the scheme will make compromise more difficult, if not impossible. Parties who cannot reliably assess risk and predict likely outcomes are ill-equipped to reach a negotiated resolution. Baseball-style arbitration is successful in bringing the parties together because they share a common understanding about how the arbitrator will decide the dispute. Based on that common understanding, each party can discern what the arbitrator is likely to view as the correct outcome, reliably predict how far the other side will stray, and design its own offer based on its objectives and tolerance for risk. But in the final-offer procedure the Board has designed, that common understanding does not exist. Because each party must submit their final offer before it even knows what methodology the other side plans to propose—let alone which methodology the Board will adopt—it cannot act in the rational way just described. The scheme's vagueness will result in unpredictable offers and random outcomes.

2. The Board refuses to acknowledge the vagueness problems that plague FORR. The Board claims it will "use the same statutory criteria and economic

principles applied in past rate cases using other processes." App. 177 (cleaned up). The Board claims it has previously decided rate cases using a "non-prescriptive, multi-factor analysis," and there is no vagueness problem if it makes decisions by "tak[ing] into account the [Rail Transportation Policy], the Long-Cannon factors in 49 U.S.C. 10701(d)(2), and appropriate economic principles." App. 177–78 (footnote omitted).

The Board's argument dodges the issue. The vagueness problems arise from the fact that the Board allows shippers to choose their own methodology—either an existing one, or a new one of their own creation—that will determine the outcome of the proceeding. That the Board intends to "take into account" the same "statutory criteria and economic principles" it has historically used does not provide constitutionally-sufficient notice if the methodology used to determine how these criteria and principles are actually applied in a given case is kept under wraps until the end. Under FORR, it would be impossible for railroads to know in advance how to conform their conduct to the law by charging a reasonable rate: The answer could be different depending on the governing methodology, which the Board will not reveal until it decides the case.

The Board mischaracterizes AAR's argument when it says AAR "assumes that the Board cannot have a rate reasonableness process unless railroads can predict the outcome of that process in advance of the Board's decision in an individual case."

App. 178. AAR's argument is not that the *outcome* must be known in advance, it is that the *methodology* the Board will use to determine rate reasonableness and prescribe a maximum rate must be known in advance. The Board also asserts that FORR will, over time, lead to the "creation of precedent" that will guide parties in future disputes and "create[ ] incentives for methodological improvements over time." App. 13. This type of reasoning—that later agency interpretations will give meaning to a vague rule—is *exactly* what the D.C. Circuit had in mind when it stated that "[i]t is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations.'" *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 584 (D.C. Cir. 1997).

Because the rule of law requires clear legal standards that are announced in advance—rather than standards that are developed ad hoc and revealed only when the decision is announced—FORR's choose-your-own-methodology approach is unconstitutionally vague under the Due Process Clause, as well as arbitrary and capricious under the Administrative Procedure Act.

B. FORR Is Not A "Method" For Determining Reasonableness.

Congress did not authorize the Board to determine the reasonableness of challenged rates in such a vague and standardless way. To the contrary, Congress authorized the Board to maintain one or more "simplified and expedited *methods* for determining the reasonableness of challenged rates in those cases in which a full

[Stand-Alone Cost] presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3) (emphasis added).

Unlike Stand-Alone Cost or Three-Benchmark, FORR is not a "method." It does not provide substantive standards to guide the assessment of whether a challenged rate is reasonable. Neither the preamble nor the text of the final rule itself gives a clue as to how the Board plans to make the threshold determination of whether the challenged rate is reasonable. Although the final rule sets forth the timetable for making this determination, it is silent as to the method the Board will employ.

FORR cannot itself be a "method" because a central feature of FORR is that the parties will choose their *own* methods. As the Board concedes, "FORR does not prescribe a particular methodology." App. 15. Accordingly, FORR is not a permissible exercise of the Board's authority to develop "simplified and expedited methods for determining the reasonableness of challenged rates" in smaller cases. 49 U.S.C. § 10701(d)(3).

III. Final Offer Rate Review Is Arbitrary And Capricious.

A court "shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). FORR is arbitrary and capricious for all the reasons explained above: It conflicts with the governing

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statutes and fails to provide an ascertainable legal standard to which regulated parties can conform their conduct. And there are three additional respects in which the final rule is arbitrary and capricious. First, the Board has disabled itself from complying with the Administrative Procedure Act's requirement that agencies engage in "reasoned decisionmaking." Second, the Board has made an unexplained departure from agency precedent in allowing up to $4 million in relief in FORR cases. And third, although the Board conceded that the risks faced by railroads and shippers under FORR are not reciprocal, it failed to recognize that this disparity makes FORR unduly coercive for railroads.

A. FORR Prevents The Board From Engaging In "Reasoned Decisionmaking."

The Board issued the final rule even though FORR will prevent the Board from engaging in the "reasoned decisionmaking" the Administrative Procedure Act requires. *See Judulang v. Holder*, 565 U.S. 42, 53 (2011) (explaining that "courts retain a role, and an important one, in ensuring that agencies have engaged in reasoned decisionmaking"); *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasizing "the requirement that an agency provide reasoned explanation for its action"); *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983) (stating that agency ruling must be "the product of reasoned decisionmaking").

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For example, if the Board believed that $100 was the maximum permissible rate—i.e., that a $100 rate was the legally correct outcome based on the statutory factors Congress directed the Board to consider—the Board would be unable to prescribe a $100 rate unless it just happened to be the rate one of the parties proposed. As Board Member Schultz concluded, FORR "prevents the Board from engaging in reasoned decision-making" because it "would require the Board to choose between two rates—even if the Board finds the correct outcome falls above, below, or somewhere in between the two submissions." App. 185.

The Board's pledge to select one of the party's final offers—regardless of whether it represents the correct outcome—runs afoul of its basic duty to use a "logical and rational" process to resolve disputes, *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998), and to draw a "rational connection between the facts found and the choice made," *State Farm*, 463 U.S. at 43. Agencies may not base their decision on considerations that are "extraneous" to the merits, and that is precisely what the Board has done by limiting its decisional options to what self-interested parties have proposed in their submissions. *Judulang*, 565 U.S. at 56. Adopting such an aberrant procedure was a "clear error of judgment" that warrants vacatur. *State Farm*, 463 U.S. at 43.

FORR would even render the Board incapable of prescribing a maximum rate in certain cases. As the Board acknowledges, it may not select a shipper's offer if

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the proposed rate will prevent the railroad from recovering 180% of its variable cost. *See* App. 13 n.21. And on the other end of the spectrum, the Board may not accept a railroad's offer if the proposed rate is the same as or exceeds the challenged rate that the Board has already deemed unreasonable. Thus, when a shipper presents an offer that is impermissibly low, and a railroad presents an offer that is impermissibly high, the Board is prohibited from accepting either. The Board claims that a FORR case "would never reach that point" because if the shipper submits an offer below the 180% threshold, "its complaint would be dismissed due to that failure of proof." App. 175. But the final rule makes clear that the Board would not even consider a shipper's final offer—and thus whether it met this threshold—until *after* it has determined that the railroad has market dominance and that the challenged rate is unreasonable. *See* App. 175. Contrary to the Board's contention, then, a FORR case could in fact reach this point, and the Board would be powerless to perform its statutory duty by prescribing a maximum rate. The Board's adoption of a rate-setting procedure that will leave cases incapable of resolution is arbitrary and capricious. An agency cannot fulfill its mandate to engage in reasoned decisionmaking if it disables itself by rule from even rendering decisions in an entire class of cases.

B. Permitting $4 Million In Relief Per Case Under FORR Is An Unjustified Departure From Agency Precedent.

An agency cannot depart from its precedent without "provid[ing] a reasoned explanation for the change." *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016). "[T]he agency must at least 'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'" *Id*. (quoting *Fox Television*, 556 U.S. at 515). "It follows that an '[u]nexplained inconsistency' in agency policy is 'a reason for holding [the action] to be an arbitrary and capricious change from agency practice.'" *Id.* at 222 (first alteration in original).

Here, the Board has a longstanding policy on how to calculate the limit on relief available under less precise and simplified rate reasonableness methods created pursuant to 49 U.S.C. § 10701(d)(3). The Board bases each limit on its "estimates of the litigation cost to pursue relief under the next more complicated and more precise method." *Simplified Standards for Rail Rate Cases*, at 27-28, EP 646 (Sub-No. 1) (STB Sept. 5, 2007). The Board adopted the policy in 2007, when it established two simplified "methods" for disputes where the value of the case cannot justify a full Stand-Alone Cost presentation. The Board's goal was to set guardrails to prevent a shipper from using "a more simplistic and less accurate procedure to challenge rates on movement." The Board reaffirmed the policy in 2016, when it adhered to this same principle in proposing to create a new simplified Three-Benchmark approach. *See Expanded Access to Rate Relief*, at 23, STB Docket No.

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665 (Sub-No. 2) (STB Aug. 31, 2016). There, the Board explained: "The [proposal] describes a process that would be significantly more streamlined than the process required to bring a Three-Benchmark case. As such, the relief available under this method would likewise need to be significantly less than the relief available under the Three-Benchmark approach." *Id.* While that proposal to create a simplified Three-Benchmark approach was abandoned in favor of this simplified final-offer approach, the Board has a consistent approach to setting limits on simplified methods adopted pursuant to 49 U.S.C. § 10701(d)(3).

Had the Board followed its precedent, the limit on relief for a case brought pursuant to this new, streamlined final-offer process would have been $250,000—its estimate of the litigation costs to pursue relief under the Three-Benchmark approach. *See* Canadian National Railway, Comments on Notice of Proposed Rulemaking at 16 (Nov. 12, 2019). Instead, the Board broke from this practice by permitting a customer to secure $4 million in relief (adjusted for inflation), the same total relief available under the Three-Benchmark approach.

The Board tries to use the vagueness of FORR to support the higher limit on relief. It states that "because FORR does not prescribe a particular methodology—nor a methodology necessarily less precise than any pre-existing procedure—the Board's prior rationale for capping relief based on the cost of the next more complicated procedure does not necessarily or neatly apply here." App. 116.

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This is not reasoned decisionmaking. An independent report commissioned by the Board surveyed best ratemaking practices and economic theory and could offer the Board no superior simplified methodology to Three-Benchmark. *An Examination of the STB's Approach to Freight Rail Rate Regulation and Options for Simplification*, at 132–34, InterVISTAS Consulting Inc. (Sept. 14, 2016), https://www.stb.gov/wp-content/uploads/STB-Rate-Regulation-Final-Report.pdf (noting that the Stand-Alone Costs tests could not be simplified beyond the Simplified-Stand-Alone Cost and Three-Benchmark methods, and that there were no alternatives to Stand-Alone-Cost-based methods that would comply with the statutory scheme). Given the compressed schedule, final-offer decision making process, and the complete absence of any prescribed methodology, the agency has offered nothing but pure speculation to justify its decision to depart from its prior practice of capping relief based on the cost of pursuing relief under the next more complicated and precise methodology.

The Board also tries to justify the relief cap by stating the higher limit on relief "further[s] the Board's intention that Three-Benchmark and FORR be used in the smallest cases, and applying the same $4 million relief cap, as indexed, would provide consistency in terms of defining that category of case[s]." App. 116. In the final rule, the agency faulted the parties for not addressing this "rationale." App. 181. But this statement is not a "rationale" for departing from the agency's

practice—it is a declaration of the agency's intent to apply the same limit to both approaches. Were the Court to accept this as a reasoned rationale to depart from agency precedent, there would be no limiting principle. The Board could declare its intention to have FORR available for the same cases as the Full-Stand-Alone-Cost methodology, and remove the limitation on relief to promote "consistency."

Absent some credible argument by the Board that this FORR process will lead to roughly the same degree of precision as the Three-Benchmark Approach, it is irrational and inconsistent with the agency's own precedent to equate the relief available under the two. *Cf. Rate Regulation Reforms*, EP 715, 2013 WL 3777631, at *15 (STB July 18, 2013) (agency equated the relief available under different methods only after a careful analysis and conclusion that "the two methods do a comparable job of detecting whether a carrier is abusing its market power through the identification of impermissible cross-subsidization").

C. FORR Is Unduly Coercive Because Railroads And Shippers Do Not Face Reciprocal Risks.

The Board failed to recognize that FORR is unduly coercive to railroads. FORR requires the railroads to choose their poison. They will be forced to either (1) effectively admit that their charged rate is unreasonable by submitting a lower "final offer," or (2) resist and run the risk that if the charged rate is found unreasonable, the shipper sets its own price for both past and future transactions. The first option would lead to an immediate and potentially significant loss; the

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second option would in many cases present an enormous risk, especially if the shipper's offer is substantially below the charged rate.

In the final rule, the Board purported to "clarif[y] that a carrier does not concede unreasonableness by submitting an offer that is lower than the challenged rate." App. 176. According to the Board, "carriers are free to argue 'in the alternative' and submit separate analyses at the rate-reasonableness and offer-selection stages." App. 176. But a carrier that submits an analysis demonstrating that the maximum reasonable rate is less than the charged rate will obviously and necessarily undermine its separate analysis demonstrating that the charged rate is reasonable. The Board tries to create the impression that there are different "stages" for the rate-reasonableness and offer-selection analyses, but under the final rule railroads must submit both analyses at the same time. *See* App. 187 (requiring railroads to submit both analyses 49 days after the complaint is filed).

FORR's all-or-nothing approach compounds the coercive pressure on railroads. If the Board determines that the challenged railroad rate is unreasonable (a predicate to rate prescription), it cannot choose that rate, even if that rate is much closer to "reasonable" than the shipper's proposed rate. Consider a case where the shipper makes a final offer of $25 and the railroad makes a final offer of $100. Even if the Board were to determine that anything up to $99 is a reasonable rate, the Board would have no choice but to accept the shipper's final offer because the statute

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prohibits the Board from prescribing a rate that is unreasonable. The shipper would obtain a windfall, and the railroad would be forced to pay reparations and provide service for the next two years at a rate far below what the Board recognizes would be reasonable.

Shippers do not face the same risks. Indeed, the Board acknowledges that under FORR "the risks faced by shippers and railroads are not reciprocal." App. 176. As Board Member Fuchs explained, "FORR may have an especially coercive, unequal effect" on railroads "because the range of outcomes in FORR are limited to either the status quo or a rate reduction." App. 184. Whereas other methodologies allow the Board to exercise its independent judgment in selecting a middle ground (i.e., a rate between the two rates advocated by the litigants), FORR forecloses that option. Railroads will be pressured to concede unreasonableness and offer still lower rates. Shippers, in contrast, do not face equivalent pressure because, as the Board acknowledges, it "would never prescribe a rate higher than the challenged rate," App. 176, and the shippers know the Board will be forced to choose their offered rate if the railroad does not come down enough. When the deck is stacked this way, railroads will be pressured to surrender their constitutional and statutory rights to defend their charged rate. Indeed, it is precisely the coercive nature of final-offer arbitration that causes its proponents to boast that it "guarantees a settlement." Carrell & Bales, *supra*, at 1.

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The Board contends that FORR is not to blame because "this lack of reciprocity is a result of the Board's statutory mandate to regulate railroad conduct rather than shipper conduct." App. 176. That argument does not make sense. That the Board does not regulate shipper conduct does not mean railroads lack the right to an even-handed process that achieves fair results without coercion. The Board's other methods for determining rate reasonableness, such as the Three-Benchmark approach, leave the Board with far more discretion and do not exert the same coercive pressure on the railroads. The Board is also mistaken in suggesting that some reciprocity exists because shippers face the risk of the railroad "raising the rate based on the analysis adopted in the Board's decision." App. 176. The railroad presumably set its rate to maximize revenues, so there is no reason to think it would raise them, even if the Board's analysis indicated that higher rates would not be found to exceed a reasonable maximum.

The Board's proposed approach differs in a fundamental respect from the way final-offer techniques are used in arbitration. Final-offer arbitration contemplates a back-and-forth process of negotiation that narrows the dispute before the final offers are presented to the arbitrator—hence the term "final" offer. Here, in contrast, the parties must submit their final offers only 35 days after the complaint is filed; there is no negotiation and thus no narrowing of the spread between offers. A central tenet of final-offer arbitration is that the process forces the parties' positions to converge

towards a reasonable compromise, but that will not happen here. This heightens the risk to the railroads and makes it even less likely they would be willing to roll the dice and defend themselves, rather than immediately accept liability and settle. Such non-market rates then become the benchmark for future cases, further driving railroad pricing down and away from market outcomes.

Compounding the pressure on railroads to abandon their defense and settle is the expedited schedule for FORR proceedings. The Board proposes giving railroads a mere 49 days to review the complaint, conduct discovery, develop their own methodology if necessary, conduct a rate reasonableness analysis, and formulate and submit a final offer. They would then have 10 days to prepare their reply, including analyzing and responding to the shipper's proposed methodology, and (in cases where the shipper uses the streamlined market dominance approach) making their market dominance presentation. Even allowing for the possibility that a motion to compel tolls the schedule, the compressed timeframe is inadequate and unreasonable. Complainants will have as much time as they wish to study the lane they will target, develop a methodology, and assemble their evidence. Railroads, in contrast, will not be given sufficient time to prepare a meaningful defense, as due process and fundamental fairness require. Typically it takes nearly four years for the Board to decide a rate case, yet the Board pledges to decide FORR cases no later than 169 days after the complaint is filed. *See* App. 114–15. This illustrates the

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absurdity of FORR's accelerated timeframe and underscores the time necessary to adjudicate a rate case with analytic integrity.

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CONCLUSION

The Court should vacate the final rule.

Respectfully submitted,

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1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7) because this brief contains 12,458 words, as determined by the word-count function of Microsoft Word 2016, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f).

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Dated: April 14, 2023.

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CERTIFICATE OF SERVICE

I hereby certify that on April 14, 2023, a true and correct copy of the foregoing Opening Brief for Petitioners was served on all counsel of record through the CM/ECF system.

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