Arbitration in Canadian and (?) U.S. Freight Rail Regulation

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The (Common) Regulated Era

- US and Canadian freight railroads have almost always owned the tracks on which they ran
- Except for some Canadian roads nationalized after WWI, since privatized, all have been private
- Federal control over rates and service in Canada began in 1905, in the US in 1906
- Trucks, buses, and planes were increasingly troublesome after WWI despite protective regulation
- Inter-city passenger service was nationalized in the US in 1971, in Canada in 1977

Partial Deregulation in the US

- During the 1970s, railroads were increasingly subsidized, some nationalized
- The Staggers Act, 1980, deregulated some commodities, allowed negotiated contracts for all others, some protection for shippers using posted tariffs
- The hope/expectation was that railroads would use their market power to raise rates enough to *survive*
- Instead, average real rates fell sharply through early 2000s, and service and profits both improved!
- Even protective regulators over-constrained the railroads, prevented cost-cutting & modernization

Post-Staggers US Shipper Protection

- A US shipper can challenge a rate only if it exceeds 180% of accounting "variable cost" – not a good MC estimate
- Must *then* show it has no competitive alternative
- *Then* generally need to show the rate exceeds cost of a RR built to serve only that shipper. OK for some coal, but…
  - Alternative tests make even less sense & are little used
- Slow, expensive ($5 million US) formal process, useless for small shippers, especially if ship to multiple places
- Congress asked National Academies, "Is there a better way?" The Academies answered in 2015.

The Canadian Alternative

- Canada deregulated freight from 1967 through 2007; results similar to US
- As in US, private contracts are allowed, & shippers can complain about posted rates
- Since 1988, complaints have been managed by independent arbitrators with 60-day time limit (30 for small matters)
- No restrictions on evidence; shipper need not be captive, but arbitrator must consider competitive alternatives
- The arbitrator must choose between the two parties' final offers; FOA encourages moderate offers

The Canadian Alternative II

- Arbitrators' decisions are not made public; hold for only one year
- 1988-2011, only 18 rate challenges brought; compromises are apparently eventually made.
- More challenges regarding service quality, which is not regulated in the US
- Concerns about this process (mainly from RRs):
  - Arbitrators may know nothing about railroads
  - Shippers may ask for and get below-cost rates
  - No precedent or predictability

A Canadian-Influenced NAS/TRB Proposal

- Dump administrative “variable cost” measures, which make no economic sense
- Instead, model rates set under rail/water competition as functions of observables (paper being finalized); treat as *competitive benchmarks*
- “Unusually high” rates relative to competitive benchmarks (how to define?) can be challenged
- Challenges to be handed to arbitrators to deal with dominance & reasonability issues with strict time limits, no limits on evidence
- Use final offer arbitration behind closed doors as in Canada
- Shippers like this; RRs behind closed doors mainly worry about definition of “unusually high”
- Unfortunately, this reform would require new legislation; not likely in Washington these days…