

COALITION OF RAIL SHIPPERS

April 22, 2015

Honourable. David L. Emerson, P.C., O.B.C.
Chair, *Canada Transportation Act* Review
350 Albert Street, Suite 330
Ottawa, ON K1A 0N5

Dear Mr. Emerson:

Attached is the submission of the Coalition of Rail Shippers (CRS) to the *Canada Transportation Act* Review.

The CRS is a coalition of industry associations whose member companies account for over 75% of the Canadian revenues of CN and CP. The CRS was created in 2006 when the government was considering legislation arising from the 2001 report of the last statutory review of the *Canada Transportation Act*.

In this paper, the CRS is highlighting five major themes related to service that impact railway customers across a broad spectrum of industries. This paper provides a context for the more specific recommendations of individual industry associations.

Members of the CRS would be pleased to meet with you, the Advisory Panel or the Secretariat to discuss the themes highlighted in the CRS paper.

Sincerely,



R.H. Ballantyne, P. Eng.
Chairman
Coalition of Rail Shippers
& President
Freight Management Association of Canada

cc: Coalition Members

COALITION OF RAIL SHIPPERS

Submission To The Canada Transportation Act Review

1.0 Introduction

The Coalition of Rail Shippers (CRS) is a group of industry associations whose member companies account for over three quarters of the rail freight customer base in Canada¹. A list of the CRS member associations is attached as Appendix 1. The CRS is pleased to have the opportunity to provide its comments to this important review of Transport Policy in general, and the *Canada Transportation Act* in particular. By definition, the CRS will comment only on rail issues and the various member associations will provide comments related to the other modes of transport as may affect their respective member companies.

Acknowledging the diverse needs of rail freight shipping industries across Canada, the CRS was formed in 2006 to identify issues that are common to many industries that are users of rail freight. All CRS members depend on effective, efficient and low-cost rail service to remain competitive in domestic and export markets. They are also united in their view that efficient transportation of commodities by rail is crucial to Canada's economic growth and economic security.

The Review of the *Canada Transportation Act (CTA)* is a priority for the CRS. The inadequacies in rail service run counter to the government's broader trade and economic development goals. Inconsistent rail service is negatively impacting the ability of Canadian industry to effectively deliver their products to customers in existing markets, and constrains our ability to take full advantage of the new trade agreements. Losing export markets to competitors, results in lost investment and lost economic opportunities for Canadian companies.

Railway transportation is a derived demand and, while the railway industry contributes to the overall economy, its contribution is directly dependent on the success of its customers. The ability of producing industries to reliably deliver their products to domestic and foreign customers is a major factor affecting their capacity for future domestic growth and development. Inconsistent rail service is restricting Canada's ability to grow and thereby threatening our economic future.

TABLE 1: GROSS DOMESTIC PRODUCT BY INDUSTRY

Sector	September 2014 (millions)	Percentage of total
All industries	\$1,644,253	
Goods-producing industries	\$495,559	30%
Agriculture, forestry, fishing and hunting	\$24,353	1%
Mining, quarrying, and oil and gas extraction	\$138,757	8%
The above three combined	\$658,669	40%
Transportation and warehousing	\$69,464	4%

Source: Statistics Canada, CANSIM, Table 379-0031

¹ Based on rail tonnage reports from Statistics Canada for the most recent year available (i.e. 2012) for the sectors represented by the Coalition of Rail Shippers.

Table 1 is a recent snap-shot comparison of the economic contribution of a sample of producing sectors, relative to the transportation sector. While not a perfect reflection of the economic impact these sectors make – as the contributions of any Canadian industry do not fit neatly into a single industrial category², nor are all sectors that ship products represented above – the table illustrates how producing industries drive economic growth in Canada. The table also communicates how producing sectors have a significantly greater capacity to impact future economic growth given the right domestic regulatory and investment environment. The effectiveness and reliability of the logistics supply chain is a key determinant of company investment decisions. Further, how well the *Canada Transportation Act (CTA)* permits a balanced and competitive relationship between producers and transportation providers is key to the effectiveness and reliability of the logistics supply chain.

1.1 The Overview of the Submission

As noted above, the rail service needs of various industry groups and individual companies differ considerably, but there are common issues and themes that impact all rail shipper groups. This paper will discuss the basic problem, i.e. the imbalance in market power between the railways and their customers, and will identify and focus on the major themes that the Review will need to consider in drafting its recommendations to the Minister of Transport. The CRS member associations have provided specific recommendations in their respective submissions to address this fundamental problem.

2.0 The Need to Counterbalance Railway Market Power

The fundamental and major challenge in obtaining a balanced relationship between rail customers and railways is the significant market power that railways have over their customers. Both the Rail Freight Service Review (2008-2011) and the federal government have recognized and acknowledged this reality in the Canadian rail freight market. The Rail Freight Service Review (RFSR) Panel stated on page 41 of its 2011 final report:

“This railway market power results in an imbalance in the commercial relationships between railways and other stakeholders.”

When former Transport Minister, the Honourable Denis Lebel, spoke to the House of Commons Standing Committee on Transport, Infrastructure and Communities, concerning Bill C-52 – *The Fair Rail Freight Service Act*, he stated that:

“It is essential for the committee to understand why this legislation is necessary. We are not dealing with the normal free market. The reality is that many shippers have limited choices when it comes to shipping their products. It is therefore necessary to use the law to give shippers more leverage to negotiate service agreements with the railways.”

The intent is to create the conditions that will allow for successful commercial negotiations that will normally be possible in a free market.”

On March 12, 2015, at the annual conference of the Saskatchewan Association of Rural Municipalities in Saskatoon, Prime Minister Harper stated that it is not in Canada’s economic interest to have two railway

² For example, the robust value-added smelting and refining sector is classified as manufacturing, as is the production of new rolling stock, agricultural and forestry equipment.

companies with “extraordinary market power” dictating terms of the transportation industry. The Prime Minister went on to say:

“We simply cannot accept outcomes where those two big companies would dictate to the market just what they think is satisfactory ... that is not going to serve the wider interests of grain farmers or the Canadian economy”.

Canada’s rail freight market is not a normally-functioning competitive market. The system is dominated by two suppliers – CN and CP, Canada’s only Class I freight railways – whose networks are characterized by dual instances of monopoly where they enjoy significant market power over their customers. Railway capacity is not established at levels designed to meet the needs of the users of the system but at levels that will maximize railway profits through aggressive asset utilization. This practice resulted in the complaints that led to the RFSR.

Bill C-52, the *Fair Rail Freight Service Act*, was the government’s latest response to the need to re-balance railway/shipper commercial relationships by giving shippers the right to an arbitrated service level agreement if one could not be successfully negotiated with railways. Despite the RFSR panel’s recommendations, specific service elements were not mandated in Bill C-52, which limits its effectiveness.

The shipper response to Bill C-52 is mixed. Since the regulations required to give effect to arbitrating service agreements have been in place, several Service Level Agreements (SLAs) have been achieved through arbitration. However, there was disappointment that none of the revisions that the CRS recommended for strengthening Bill C-52 were accepted by the government, and it is yet to be seen how effective these agreements will be for shippers to obtain improved service. The inadequacy of Bill C-52 – which passed into law in June 2013 – did not prevent rail service failures later that same year and into 2014. This led to the tabling of Bill C30 *Fair Rail for Grain Farmer’s Act*, which did not address the systemic nature of rail service failures and created new challenges.

Bill C-30 enacted legislative measures that were focused primarily on assisting the grain sector. While the overall shipping community remains sympathetic to the plight of the grain industry, a single sector approach to addressing a systemic issue will not be successful in increasing overall capacity for all rail shippers. If we are to increase rail capacity and rail service to meet the needs of the Canadian economy as a whole, solutions must be found that address the systemic nature of rail service challenges experienced by all rail shippers.

In its October 3, 2014 decision in the application by Louis Dreyfus Canada Ltd. against the Canadian National Railway Company, pursuant to section 116 of the *Canada Transportation Act* (Case No. 14-02100), the Canadian Transportation Agency stated as follows.

[12] *The Agency recognizes that transportation is a derived demand. Freight railway companies do not operate except to carry goods that are produced by other economic actors and it is the financial health of these primary economic actors that is protected by sections 113 to 115 of the CTA. However, these actors have competing interests. Essentially, the interests of the shipping community are best served by a transportation system with high capacity and intense competition. The interest of the railway companies is embodied in the industry phrase “sweating the assets,” which implies meeting the demand with the lowest possible cost in terms of infrastructure, car supply, crews and motive power. High efficiency operations with low operating ratios (typically measured by costs as a proportion of total revenues from operations) provide the best return to railway company shareholders. However, running a very lean*

operation has implications for the railway company's ability to manage surges in demand or operational challenges such as infrastructure outages or adverse weather.

[13] *The Agency is of the opinion that where competitive pressures are low or absent and where there is a relatively low cost to the railway company for delaying traffic or otherwise reducing the level of service, the supply of cars and motive power will tend to be set at a level that favours railway company (producer) preferences over shipper (consumer) preferences.*

Customer captivity, coupled with the railways' power to unilaterally impose rates, ancillary and penalty charges and conditions of service, enables the railways to raise prices and reduce service without risk of losing their customers. This captivity characterizes the imbalance inherent in Canada's monopolistic rail freight bargaining structure. It is the combination of shipper captivity and a regulatory framework that that does not effectively constrain the continued exercise of railway market power.

2.1 Comments on CTA Shipper Remedies:

Canadian Railway law has recognized the market power of the railways for over a century. That the current Act has remedies available to rail customers is recognition of the continuing market imbalance between railways and their customers. The remedies were included in the Act in an attempt to curb the market power the railways have over their customers. The problem with the current suite of remedies, however, is that they are expensive and are not easily accessible to all shippers, especially small and medium size companies. The table provides an overview of the hurdles in using some of these remedies.

TABLE 2: VARIOUS SHIPPER REMEDIES, AND APPROXIMATE COSTS AND TIMELINES

Available Remedies	Cost and Time to Pursue Remedy (does not include preparation time, appeals and motions)
Contractual claims: <ul style="list-style-type: none"> • Damages • Specific Performance 	<ul style="list-style-type: none"> • Contractual claims (damages and specific performance): between \$200,000 to over \$1 million • Two+ years
Commercial dispute resolution	<ul style="list-style-type: none"> • Commercial dispute resolution: from \$200,000 to over \$1 million • Possibly less than 1 year
Level of Service (LOS) complaint	<ul style="list-style-type: none"> • LOS: between \$150,000 to over \$400,000 • 120 days statutory period to one year with Agency extensions
Service Level Arbitration (SLA)	<ul style="list-style-type: none"> • SLA: between \$250,000 to over \$1 million • 30 days plus arbitrator's discretionary extensions

The following remedies are also available to shippers and potentially useful, but most have significant barriers to be able to be used effectively. Several CRS members have made recommendations to overcome the barriers.

- Final Offer Arbitration of Freight Rates – time consuming and expensive
- Challenging the reasonableness of ancillary and penalty charges – time consuming and expensive
- Regulated Interswitching – generally works well with regulated rates
- Competitive Line Rates – does not work at all; the railways have been able to render this provision ineffective. It needs to be replaced.

Upon reviewing the above, it becomes clear why companies are hesitant to utilize current *Canada Transportation Act* remedies. While persistent service failures of a smaller scale add up to large amounts over time, frequently no single event merits risking the cost associated with the remedy to address the loss to the company that the single failure generates. This is especially true as there are no guarantees of winning. In fact, in many instances, given the lack of railway performance and capacity data disclosure (discussed further below), shippers face an uphill battle making their case in regulatory proceedings. Further, in many instances, due to the tariff making power of the railways discussed above, a railway loss in a remedy contest is frequently made up indirectly through increased rates. There is also the threat of unilateral railway retribution that can inflict commercial pain on the rail customer.

The most positive use of these remedies comes in those few cases when a shipper formally notifies the railway that it is filing a complaint and this brings the railway to the table and the two parties are able to come to a negotiated agreement.

2.2. Addressing the Imbalance in Marketing Power

In summary, options for directly increasing competition in the rail freight market are very limited and there is no reasonable prospect of increasing railway competition by commercial means. As this is the fundamental problem, the Review will need to look at regulatory and other options that will act as a surrogate for real competition. Beyond the themes in sections 3.1 to 3.5 outlined below, the CRS member associations have provided specific recommendations in their respective submissions to address this fundamental problem.

3.0 CRS Strategic Goals for the Review

To address the reality and consequences of railway market power in the Canadian rail freight market, the CRS has identified several general themes where improvements should be made. The CRS is not making specific recommendations in this paper but notes the universal support of the shipper community for improvements in these areas. Various CRS members have provided recommendations on these themes in their respective submissions

3.1 Theme 1: Review Recommendations should reflect the “user-focused” orientation of the National Transportation Policy

Section 5 of the *Canada Transportation Act* (CTA) denotes Canada’s National Transportation Policy:

*It is declared that a competitive, economic and efficient national transportation system that meets the highest practicable safety and security standards and contributes to a sustainable environment and makes the best use of all modes of transportation **at the lowest total cost is essential to serve the needs of its users**, advance the well-being of Canadians and enable competitiveness and economic growth in both urban and rural areas throughout Canada.*

It is important to highlight that the above policy clearly states that the transportation system is in place to serve its users and not for its own sake. In this sense, transportation operators are of strategic “national interest” given how the quality, reliability and effectiveness of their service delivery has a direct effect on producers, job growth, international trade, and other national strategic considerations related to economic security. It is important that the Review reinforce the importance of these policy objectives.

3.2 Theme 2: Protect and strengthen the Statutory Service Obligations within the Act

Specifically: Strengthen the statutory service obligations within the CTA so that the level of service provided by the railway must meet the rail transportation requirements of the shipper. Currently, section 169.37(b) of the CTA requires an arbitrator to have regard to the service that the shipper requires for the purposes of service level agreement arbitration. The service that the shipper requires should be the focus of the level of service obligations set out in sections 113 to 115 of the CTA.

Railways in Canada have had a statutory duty to accept all traffic offered since the first *Railway Act* of 1903. Despite this obligation, in recent years, railways have suggested that they be relieved of the duty to carry dangerous goods on the grounds that if they are found to be negligent in an accident, they will be held financially responsible for the consequences. The underlying premise of this position is that railways would not carry dangerous goods if they were not required to by law. This is why the *Canada Transportation Act* Review Panel needs to affirm that the statutory level of service obligation should continue to apply to all traffic including dangerous goods traffic. Despite the risk of accident, rail delivery of dangerous goods, whether in single cars to a remote mine site, or in unit trains from a refinery, remains the safest means of transporting virtually all dangerous goods, especially when compared to movement by truck. Further, their transport by rail is essential for the functioning of the Canadian economy.

3.3 Theme 3: Improve data collection and availability to increase transparency and accountability in the rail freight market.

Collecting and publishing railway data, as is permitted under sections 50 and 51 of the *Canada Transportation Act* and is already done to some degree for the agriculture sector, would not only enhance transparency in the transportation system, but may also improve relations between shippers and transportation service providers, avoid unnecessary and costly disputes, and provide government with the tools necessary to identify, assess, and resolve existing challenges. This single measure would go a long way toward:

- Rebalancing the bargaining positions between railways and their customers as claims of inadequate service by shippers, or sound performance by railways, would be able to be assessed transparently based quantitative analysis and not qualitative claims.
- Improve the functionality of the remedies in the Act by:

- Reducing the length of time required to “make a case” – if data is available, arbitrators can assess respective rail or shipper claims based on actual data-based performance and not perceptions of performance.
- Reducing the cost burden on all shippers in accessing the remedies– thus making the remedies more accessible to small and medium shippers – because the vast majority of legal expense is in time allocated to “making the case” in advance of the actual hearing. Data availability would significantly reduce the front-end time and cost commitment currently required to prepare for a hearing
- Help assess the adequacy of railway capacity relative the claims railways make:
 - Disclosing such data would permit the Agency to analyze network capacity versus demand and growth potential and continuously monitor with the objective of identifying capacity constraints before they affect shippers.

In addition to collection and dissemination of service information, there is a need for aggregated pricing information to be made available to shippers, as it is in the United States through the Surface Transportation Board (STB). CN and CP currently provide waybill data to the STB on their cross-border and U.S. domestic traffic. The STB has developed processes for keeping individual shipper data confidential, but are able to aggregate it in such a way that, if available in Canada, would provide ranges of data that assist shippers in their negotiations and in pursuing rate disputes through Final Offer Arbitration (FOA). Providing such data would be another way to rebalance the relationship and provide cost-effective tools to address pricing and service issues.

CRS members have provided specific recommendations to give effect to this fundamental need for data.

3.4 Theme 4: Investigative Powers of the Canadian Transportation Agency

Currently, the Agency carries out investigations pursuant to complaints filed by shippers or other stakeholders. Where the Agency sees trends in complaints, it would be useful for the Agency to have the authority to undertake investigations on its own initiative. The Agency is in the best position to recognize such trends and, as noted above, shippers may be reluctant to bring complaints forward for fear of retaliation and because of the costs and uncertainty of outcome.

3.5 Theme 5: Railway Capacity to Meet Growing Demand

In its annual publication *Rail Trends*, the Railway Association of Canada reports growth of 29% in revenue ton-miles [RTM] (revenue tonne-kilometre) over the past decade, i.e. from 235 billion RTM in 2004 to 291 billion in 2013.

While the railways do invest in infrastructure capacity and in equipment, there is mounting evidence that parts of the railway network are having difficulty recovering from service outages due to natural causes, derailments, short-term unexpected surges in demand, or work stoppages. It is necessary that the rail network have the resilience to recover from outages quickly and to meet the forecast growth for rail service and to provide time for necessary track maintenance including rail, tie and ballast replacement.

It would be useful for the Review to comment on the long-term needs for capacity improvements and identify the likely sources of investment.

4.0 Conclusion

Lack of adequate rail capacity and service has recently resulted in a high level of attention to the matter of rail service and the imbalance in accountability between railways and rail freight customers. However, the fundamental underlying problems have been present for decades.

The themes in section 3 all relate to the basic problem of railway market power and the need to rebalance the bargaining power between the railways and their customers. The railways should be held accountable to the same level of performance to which they hold shippers. In this connection they have pricing powers pursuant to the Act which give them significant leverage in influencing shipper operational behavior.

Government policy, as stated in Section 5 (a) of the *Act* expresses a preference for “competition and market forces” to be “the prime agents in providing viable and effective transportation services”. The shipper community shares this view but, as stressed throughout this paper, is faced with a rail freight market in which “competition and market forces” are sadly lacking.

The CRS would be pleased to meet with the Chair of the Review and the Advisory Panel to discuss the shipper-railway relationship and its recommendations.

Ottawa, ON
April 22, 2015

Appendix 1**COALITION OF RAIL SHIPPERS MEMBERSHIP LIST**

- Animal Nutrition Association of Canada (ANAC)
- Barley Council of Canada (BCC)
- Canadian Association of Recycling Industries (CARI)
- Canada Grains Council (CGC)
- Canadian Canola Growers Association (CCGA)
- Canadian Steel Producers Association (CSPA)
- Canadian Renewable Fuels Association (CRFA)
- Forest Products Association of Canada (FPAC)
- Global Automakers of Canada (GAC)
- Grain Growers of Canada (GGC)
- Inland Terminal Association of Canada (ITAC)
- Pulse Canada
- Shippers Council of Canada, a coalition of:
 - o Chemistry Industry Association of Canada (CIAC)
 - o Canadian Fertilizer Institute (CFI)
 - o Freight Management Association of Canada (FMA)
 - o Mining Association of Canada (MAC)
- Western Canadian Wheat Growers Association (WCWGA)
- Western Grain Elevator Association (WGEA)