BUDGET FORESHADOWS SIGNIFICANT CHANGES TO FEDERAL TRANSPORTATION REGULATION

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On March 28, 2023, the Government of Canada tabled its 2023 Budget , which foreshadows significant proposed changes to the federal transportation regulatory regime. The Budget responds to a few of the recommendations in the final report of the National Supply Chain Task Force (**NSCTF**) released October 6, 2022.

The Budget introduces six surface transportation measures (spending initiatives, a collaboration exercise, data demand from shippers, a temporary regulatory change, and a review of marine legislation). The Government has framed these measures as “a down payment on Canada's National Supply Chain Strategy, which will be released in the coming months and will be informed by the recommendations of the National Supply Chain Task Force report”. Below we identify and analyze current developments of interest to rail freight shippers in Canada.

Why is the Government Addressing Rail Shipper Concerns?

Both Liberal and Conservative governments have recognized that the Canadian economy is much better off when rail shippers have the benefit of competition. Unfortunately, competition for rail services is largely unavailable. As acknowledged by the NSCTF:

> “Railways are the only source of transport for many shippers, giving rail companies pricing and service discretion that is not balanced by normal market forces.” [1]

While the Budget does not deal with well-understood supply chain shortcomings that are contributing to inflation and the loss of jobs and earnings, the thrust of the Budget is future legislation will reign in railway market power over rates and service levels to address these longstanding concerns .

Extending Interswitching Limits

In a prior bulletin , we recommended a significant extension of the interswitching limit consistent with the NSCTF's recommendation to expand the interswitching limits “across Canada to give shippers more rail options and to address shipper-railway power balance issues”.

The government's Budget proposes a very limited "temporary extension, on a pilot basis, of the interswitching limit in the prairie provinces", but does not set out the new limit, nor any rationale for the limitation to the prairie provinces or the pilot program.

This temporary change takes us back to the *Fair Rail for Grain Farmers Act* of 2014 that, as we previously reported , allowed the Canadian Transportation Agency (**Agency**) to extend interswitching limits from 30 km to 160 km for the three prairie provinces. Those extended limits remained available until 2017, following which the current government let the legislation expire, thus restoring the 30 km limit across Canada.

Will the Temporary Extension of Interswitching Work?

The limited temporary extension to the regulated interswitching limits will help few shippers. It will shut out rail shippers that cannot use the remedy, such as (i) shippers outside the current 30 km limit in provinces outside the prairies, (ii) shippers in the prairie provinces located beyond the extended limit, and (iii) shippers who are captive to the same railway at both origin and destination. These shippers need access to effective competition, whether via actual competition or effective surrogates for that competition, to provide some semblance of balance to the service and pricing power CN and CP enjoy over vast swaths of their networks in Canada.

Is there a Need for a Pilot Program to Study Regulated Interswitching?

The Railway Association of Canada (**RAC**) published a news release [2] in response to the Budget containing several refutable claims regarding the impact of extending regulated interswitching limits.

- **Congestion** : There is no evidence that extending regulated interswitching causes congestion, as RAC claims. Instead, CN and CP maintain their ability to exercise market power by preventing shipper access to another railway. Even if there were evidence of such congestion, CN and CP could avoid it altogether by offering competitive rates and conditions of service. Shippers stand behind the NSCTF recommendation to extend interswitching "across Canada to give shippers more rail options and to address shipper - railway power balance issues". [3]
- **Disincentive to private investment**: The RAC regularly raises this alleged disincentive. However, a basic benefit of competition leads to the opposite conclusion. By providing competitive rates and service levels, CN and CP would send the correct price signals to rail shippers to allow them to make better investment decisions. As it stands, CN and CP decide whether or not to invest in their infrastructure in a way that maximizes their systems, not the entire supply chain.
- **Efficiency, capacity and reliability**: There is no need for a pilot program. The volume of traffic that railways transferred between each other using the limited extension of regulated interswitching (160 km) that was in place from 2014 to 2017 was quite small. According to information the Agency provided to the

House of Commons Standing Committee on Transport, Infrastructure and Communities in 2016,[4] a mere 600 railcars were interchanged beyond the 30 km radius during the last six months of 2014 (a year in which railways in Canada originated over 4 million carloads[5]). The number grew to approximately 2900 in 2015, which accounted for less than 0.1% of the total carloads of all traffic and less than 0.6% of the total carloads of grain originated in Canada that year. Actual data confirming any adverse effect on efficiency, capacity or reliability, if it exists, has not been made available.

What about everyone else?

Even if there were some remedial relief for a few shippers in the prairie provinces who had access to their customers using more than one railway via extended interswitching, all other rail shippers would be left out. Extending the limits to 1200 km across Canada, as we recommend, would help introduce duopolistic competition for some shippers, but is unlikely to help those shippers whose traffic is captive to the same railway at both origin and destination.

Those excluded shippers need a remedy, too. There are numerous ways to address this significant, inflationary, productivity-depressing problem. We recommend starting by eliminating remedies that do not work and replacing them with those that do.

Repeal Long Haul Interswitching

Bill C-49 (the *Transportation Modernization Act*), established a new remedy known as long-haul interswitching (**LHI**). As we reported in May 2017, the LHI remedy is severely limited. Indeed, rather than "championing" LHI, as RAC has claimed,[6] many shippers and shipper organizations expressed concerns about the usefulness of the remedy during the legislative process. In fact, no shipper has pursued a LHI application since its implementation five years ago. We recommend repealing the LHI remedy without delay.

Fix Existing Remedies

A comprehensive set of further recommendations are beyond the scope of this bulletin, but should include amendments to the remedies that CN and CP have rendered ineffective or that have failed to achieve their intended purpose. Those amendments must take into account years of failure to achieve the long-stated purpose of national transportation policy to deal with the fact that railway market power is "not balanced by normal market forces".

Excessive Rail Rates

The RAC repeatedly asserts that CN and CP "offer the lowest rail freight rates among leading trading nations...showing the robust competition that exists between Canadian railways".[7] A previous RAC news release appended a report by consulting firm CPCS that makes similar assertions.[8] That report uses flawed methodology. Among several other deficiencies, the report does not attempt to ensure that its analysis compares Canadian rail rates to comparable traffic in other countries. The importance of that principle has been acknowledged in Canada for decades, including in the 2001 report of the *Canada Transportation Act* Review Panel.[9] Consequently, the CPCS report compares data for railways in countries that have predominantly short-haul traffic to Canadian rail rates, which are significantly longer-haul on average, a basis of comparison that has long been debunked, as the RAC is well aware.[10]

Compelling Shippers to Provide Data

The Budget also proposes to introduce amendments to the Act to provide the Minister of Transport with "the authority to compel data sharing by shippers accessing federally regulated transportation services". The Budget does not identify

i. the scope of the data disclosure to be required from shippers,
ii. any minimum volume a shipper must meet before triggering the disclosure obligations,
iii. the recipients of the data, or
iv. the intended uses of the data.

In our view, this is unnecessary and premature. Transport Canada should strongly consider focusing its efforts on assessing and disclosing actual rail infrastructure capacity, as discussed in our January 2023 bulletin, before requiring additional data disclosure from shippers or committing additional tax-payer funds to infrastructure development when there is no current basis on which to decide where that infrastructure is needed.

[1] NCSTF report, page 18.
[2] See RAC news release dated March 28, 2023: Canada's Railways Respond to Budget 2023.
[3] NCSTF report, page 18.

[4] Evidence before the Standing Committee on Transport, Infrastructure and Communities, 42nd Parliament, 1st Session, September 20, 2016, p. 4 and p. 8.
[5] See Rail Trends | 2016.
[6] See Expanding Regulated Interswitching? Bad for supply chains. Bad for everyone.
[7] See RAC news release dated March 28, 2023: Canada's Railways Respond to Budget 2023.
[8] See RAC news release dated February 13, 2023: Independent report confirms Canada's freight railways are among world's lowest cost to shippers.
[9] See *Vision and Balance*, Report of the *Canada Transportation Act* Review Panel, June 2001, page 67 (Report of the *Canada Transportation Act* Review Panel): "When identifying the traffic whose revenue will be used to calculate CCR, the Agency will need to ensure that it compares like with like in terms of traffic, distances

moved, level of service provided and conditions of carriage."
[10] See *Vision and Balance,* page 68: "…because of rate taper, revenue per tonne-kilometre would be lower for longer movements than for shorter ones." Footnote 5 on page 98 expands on the point: "In general, the two most costly components of any rail movement, on a per tonne-kilometre basis, are picking up traffic from a shipper's siding and delivering it to the consignee's siding or an interchange with a connecting carrier. By contrast, the line haul costs, on a per tonne-kilometre basis, are much lower. Because origin and destination switching costs are spread over more kilometres for longer movements, cost (and revenue) per tonne-kilometre decline as the length of movement increases. The above provides an illustration of rate taper."

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.