



Western Canadian Shippers' Coalition

Presentation to the
Canada Transportation Act
Review Panel

Submitted by the
Western Canadian Shippers' Coalition

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Table of Contents

About the Western Canadian Shippers' Coalition	1
Introduction	2
The <i>National Transportation Policy</i>	2
Competition in Rail Freight Transportation	3
Railway Market Power	4
Recommendations	5
Extended Interswitching Limit	5
Final Offer Arbitration.....	6
Level of Services	7
Contracts	8
Reasonableness of Tariffs	9
Conclusion	9

About the Western Canadian Shippers' Coalition

The Western Canadian Shippers' Coalition ("WCSC") represents Canadian-based companies and associations that move mainly resource products through the supply chain to domestic and international customers.

WCSC members:

- provide tens of thousands of direct and indirect jobs for Canadians in communities across the west; and
- transport and ship billions of dollars' worth of product annually.

The WCSC membership is comprised of shippers from a number of different commodity groups, including:

- forestry;
- metals;
- mining;
- petroleum;
- sulphur; and
- cement/aggregate.

The point of commonality for members of the WCSC is a reliance on market-dominant providers of rail freight, truck and port transportation services. WCSC member companies compete head-to-head in world commodity markets against producers from the United States, Asia, Europe, Scandinavia, Australia and South America. Rail freight transportation costs and service reliability are major factors in determining whether or not WCSC member companies prosper, simply endure, or struggle to meet the competitive pressures of their respective markets.

Introduction

WCSC members rely on rail freight transportation to help them succeed in global markets where they are price takers facing fierce competition. The WCSC is accordingly pleased that the Review Panel has been asked to provide an independent assessment of how federal policies and programs can ensure that the transportation system strengthens integration among regions while providing competitive international linkages.

Access to rail freight transportation on competitive terms and effective and sensible measures to mitigate the railways' market power are matters of significant concern to the members of the WCSC. A lack of competitive access to rail and the exercise of disproportionate market power by railway companies significantly hinder the ability of Canadian producers to compete effectively in international markets. The impacts of this market power include the erosion of shippers' cost competitiveness through annual freight rate increases that consistently far exceed inflation. They also include the decline of service reliability as rail capacity falls well short of the predictable demand from shippers. This is both an ongoing challenge for current shippers and a significant factor for firms contemplating greenfield/brownfield projects in evaluating investment opportunities in Canada. The result is lower levels of economic activity than would be experienced with more effective mitigation of railway market power.

In order for Canadian producers to prosper internationally, it is imperative that rail freight transportation be efficient and cost effective. Competition and means to mitigate the railways' market power are essential to the realization of each of these aims.

The National Transportation Policy

Section 5 of the *Canada Transportation Act* (the "CTA") sets out Canada's National Transportation Policy. The current National Transportation Policy declares that, "...a competitive, economic and efficient national transportation system..." is essential to advance the well-being of Canadians and enable competitiveness and economic growth in both urban and rural areas in Canada. The Policy goes further to state that this overall objective will most likely be achieved when, among other things:

- competition and market forces are the prime agents in providing viable and effective transportation services;
- regulation and strategic public intervention are used to achieve outcomes that cannot be achieved satisfactorily by competition and market forces alone; and
- rates and conditions do not constitute an undue obstacle to the movement of traffic within Canada or to the export of goods from Canada.

The National Transportation Policy recognizes that competition and protection against obstacles created by the railways' disproportionate market power are essential to ensure an efficient, competitive, and cost effective transportation system. These principles should inform the Panel's considerations throughout the course of its Review.

Competition in Rail Freight Transportation

There are situations in Canada where shippers are served by only one railway at origin and have no realistic alternative to rail transportation. This is a prevalent situation for the resource-based industries of Western Canada; in particular, the grain, sulphur, coal, forest products and, where pipelines are at capacity, petroleum industries, among others. The large volumes shipped and the long distances involved in transporting such commodities to tidewater or market destinations in North America preclude the utilization of truck transport. For all practical purposes, the resource-based industries of Western Canada are captive to rail transportation.

The inability to access a national transportation system that is truly competitive, economic and efficient has resulted in shippers seeing their international competitiveness decline in the face of tough international market competition and in the face of annual price increases set by the railways for their services at levels well in excess of general inflation. At the same time, and in spite of record cash flows and profits, railways have continually failed to make sufficient capital additions to meet the reasonable requirements of western shippers. Railway companies should be required to make investments to ensure that their networks can handle the additional capacity brought online in both the natural resource and consumer products sectors. This captivity and the lack of investment in the rail system in Canada will continue to seriously impair the international competitiveness of Canadian shippers to the detriment of the national economy.

To enhance competition in the railway sector, the National Transportation Policy must continue to recognize that competition and market forces are the prime agents in providing efficient and cost-effective transportation services. This intent should be given effect through the CTA in order to provide the practical, effective, and competitive rail transportation options shippers require to survive in the global marketplace. WCSC's submission sets out the legislative changes that are required to achieve this objective.

Railway Market Power

For most of their history, railways in Canada have been treated as regulated monopolies. Through various enactments from 1967 to date, railways have been deregulated to the point where they are now shareholder-owned, private sector, commercial entities with the right to make market choices and decisions involving capacity, service and pricing. However, what makes railway companies different from other private enterprises is that they continue to enjoy virtual monopoly power over large sectors of the economy. Significant segments of the railways' business in Canada are completely dependent on rail to meet their transportation needs and often have access to only one railway company.

The economic interests of shippers and railways, while in many aspects aligned, differ in important respects. Shippers, and the economy as a whole, benefit from an efficient railway system with sufficient railway capacity to move commodities quickly and in a manner responsive to the demands of shippers' end markets. Railway companies, on the other hand, benefit when capacity is constrained to minimize costs and to support higher pricing. Running a lean operation with fewer railway assets provides the best return to the railway company's shareholders, but it hampers the railway company's ability to provide the timely service required by shippers. Moreover, while access to cost-effective transportation is essential for Canadian shippers to compete internationally, the railway company's shareholders demand the highest possible revenue from operations. Where the shipper does not have the option of taking its business elsewhere, the interests of the railway company's shareholders typically trump those of the shipper. There is little incentive for any other result.

While shippers have generally supported the transition of federal railways from regulated entities to commercial enterprises, legislation continues to be required to temper the railways' market power and to ensure that they meet not only the expectations of their shareholders but also the responsibilities that come with the unique position they occupy in the national transportation system. WCSC's submission contains recommendations that are required to protect shippers and the Canadian economy from the disproportionate market power of railways.

Recommendations

WCSC's recommendations are as follows:

1. Make the expanded interswitching limit of 160 kilometres permanent and applicable to all shippers in Western Canada;
2. Make the final offer arbitration process more efficient, transparent and accessible by:
 - a. eliminating the requirement that the arbitrator embark on a detailed analysis of whether effective and competitive alternatives exist;
 - b. requiring the railway companies to provide access to the costing information underlying their final offers; and
 - c. at the option of the shipper, increasing the period for which an arbitrator's decision may be binding to a maximum of three years;
3. Strengthen the current level of services provisions while adding transparency to railway performance in key objective measures;
4. Limit railway companies' ability to contract out of the basic shipper protection provisions in the CTA and to impose undue liability on shippers; and
5. Provide a process under the CTA for challenging the reasonableness of all aspects of railway tariffs, analogous to the existing process for challenging the reasonableness of domestic air carrier tariffs which:
 - a. allows the Agency to act on its own initiative and on complaint by "any person";
 - b. clarifies that the Agency's jurisdiction extends to terms and conditions even if they are not directly related to "charges"
 - c. eliminates the mandatory factors which the Agency must consider; and
 - d. eliminates the requirement that the Agency's order must be of a specified (and limited) duration.

Each of these recommendations is discussed in more detail below.

Extended Interswitching Limit

Effective August 1, 2014, the *Railway Interswitching Regulations* were amended to increase interswitching distances, on a temporary basis, from 30 kilometres to 160 kilometres in Alberta, Saskatchewan and Manitoba. For the remainder of the country, the interswitching distance continues to be 30 kilometres. The extended interswitching distances in Alberta, Saskatchewan

**Presentation to the
Canada Transportation Act Review Panel
Submitted by the Western Canadian Shippers' Coalition
December 2014**

and Manitoba will be repealed on August 1, 2016 unless, before that date, their repeal is postponed by resolution passed by both Houses of Parliament.

Regulated interswitching is a well-established and effective means of promoting intra-modal railway competition. The *National Transportation Policy* states that “competition and market forces, both within and among the various modes of transportation, are the prime agents in providing viable and effective transportation services”. The Regulatory Impact Analysis Statement published along with the *Regulations Amending the Railway Interswitching Regulations* states that, “[t]he objective of these Regulations is to increase the access that shippers have to the lines of competing carriers, which in turn will increase competition among railways for business, and thereby give shippers more transportation options.” The amendments to the *Railway Interswitching Regulations* were clearly intended to give effect to the *National Transportation Policy* by creating competition for shippers in Alberta, Saskatchewan and Manitoba.

Competition should not be temporary, nor should it be limited to shippers in the Prairie Provinces. Shippers throughout Western Canada, including B.C., should have a right to receive viable and effective transportation services through competition and market forces in accordance with the *National Transportation Policy*. WCSC supports making the extended interswitching limits permanent and applicable to all shippers in Western Canada, including those in B.C.

Final Offer Arbitration

The only remedy in the CTA on which WCSC members are able to rely in conducting freight rate negotiations with CN and CP is the final offer arbitration (FOA) process. While this process works and has been described as providing an incentive to reach a negotiated resolution, it is very costly and often cumbersome. WCSC supports making this process more accessible.

In particular, section 164(2) of the CTA requires an arbitrator, unless the parties agree otherwise, to “have regard to whether there is available to the shipper an alternative, effective, adequate and competitive means of transporting the goods to which the matter relates”. This provision singles out one among many potentially relevant considerations and invariably requires the shipper to provide evidence with respect to each and every theoretically possible means of transport for its product, explaining why that means of transport is not “effective, adequate and competitive”. This includes evidence of the cost and impracticalities of each alternative mode of transport. Preparing and presenting this evidence significantly increases the complexity (and ultimately the cost) of the final offer arbitration process and discourages shippers from utilizing it.

WCSC supports streamlining the FOA process by deleting the requirement that the arbitrator have regard in each and every case to whether an effective and competitive alternative means of transporting the goods at issue exists. Doing so will focus the issue on the rates that ought to apply to the traffic and eliminate preliminary wrangling over other means of transport, such that the process will become more efficient and accessible for shippers.

The FOA process will also become more accessible for shippers if the railway companies are required to provide access to the costing information underlying their final offers. Not only will such information allow the arbitrator to come to a more informed decision, providing such information at an early stage in the proceeding would also be highly conducive to promoting settlement between the parties before reaching the arbitration stage.

Paragraph 165(1)(c) of the CTA provides that, unless the parties agree otherwise, the decision of the arbitrator is binding only for a period of up to one year. As a result, the shipper and the railway company may find themselves in an FOA on an annual basis. WCSC recommends giving shippers the option of increasing the period for which an arbitrator's decision may be binding to a maximum of three years.

Level of Services

Sections 113 to 115 of the CTA establish a railway company's statutory level of services obligations. WCSC supports maintaining and strengthening the current level of services provisions located in sections 113 to 115 of the CTA. These provisions represent an essential recourse for shippers who have suffered poor service in dealing with a railway that enjoys superior market power.

In January 2011, the final report of the Rail Freight Services Review found "significant service problems" within the rail transportation system. The Panel also found that the effectiveness of the shipper protection provisions in the CTA, including the level of service provisions, was "somewhat limited" and that the provisions "did not ensure that service was reasonably adequate". However, the Panel decided against recommending the strengthening of sections 113 to 115 of the CTA at that time. Instead, in response to the concerns raised in the Rail Freight Services Review, Bill C-52 amended the CTA to allow for level of service arbitration. While the level of service arbitration provisions may be of some benefit to some shippers, they have not resolved the "significant service problems" that continue to plague the rail transportation system.

WCSC believes that the level of service provisions should be strengthened to clarify that a railway company must fulfil its service obligations in a manner that meets the shipper's rail transportation requirements. Requiring the railway companies to provide only a "reasonable" level of service, as the CTA currently does, allows service levels below those required by shippers to become the status quo. That leaves the supply chain operating only at a "reasonable" level, assuming that the railway companies fulfill their statutory obligations. To compete internationally, the Canadian supply chain needs to be more efficient. While this will require investment by the railway companies in assets such as line capacity, cars, and manpower, it is in the interest of the economy and ultimately all Canadians to ensure that the railway companies provide efficient service that meets the requirements of all natural resource and commodity sectors and maintains a fluid supply chain.

**Presentation to the
Canada Transportation Act Review Panel
Submitted by the Western Canadian Shippers' Coalition
December 2014**

Currently, the CTA provides for the monitoring of the grain transportation and handling system. This includes regulations requiring railway companies engaged in transporting grain to provide detailed information regarding grain shipments to the Minister and regular reports by the Grain Monitor which include aggregated data relating to the performance of the railway companies in transporting grain. However, shippers of other commodities are unable to obtain metrics to quantify the performance of the railway companies and ensure that the supply chain as a whole is operating efficiently. WCSC recommends a broader monitoring system requiring the railway companies to provide aggregate regional metrics as they relate to all commodities, including:

- information about existing railway assets, including the number of cars, car types, locomotives, and the locations or areas in which those cars operate;
- employee and crewing information by province along with shortfalls;
- railway shipments by destination province or state, car type and origin province for each commodity;
- car cycle times by commodity;
- loaded transit time by commodity; and
- railway traffic density by commodity.

Contracts

As page 10 of the CTA Review Discussion Paper recognizes, the CTA “contains a number of ‘shipper protection’ provisions to address concerns about the potential abuse of market power by the railways” and the Agency is “empowered by the Act to enforce these provisions”. However, the CTA does not prevent a railway company from contracting out of these shipper protection provisions and thereby neutering the Agency’s ability to enforce them.

Railway companies attempt to force shippers to enter into confidential contracts that displace the railway company’s obligation to provide an adequate and suitable level of services, restrict the shipper’s statutory right to seek redress from the Agency through a level of services complaint, and preclude the shipper from asserting its statutory right to require the railway company to offer a service level agreement or to commence a service level agreement arbitration. Shippers who refuse to sign such contracts are prevented from negotiating specific rates, terms and conditions for their traffic and are instead forced to ship in accordance with the rates, terms and conditions unilaterally set by the railway company.

Railways should not be permitted to undermine the Agency’s authority by contracting out of the basic “shipper protection” remedies contained in the CTA. WCSC supports including in the CTA a provision expressly stating that no person may waive or contract out of any requirement in the CTA or its regulations, except as expressly permitted, and any attempt purporting to do so is void.

Railways also use their market power to force shippers to accept contracts that impose undue liability on the shipper with respect to third parties. The railway companies are required by the CTA to carry third party liability insurance with respect to their activities and are in a better position both to prevent railway accidents and to remedy the damage that such accidents

cause. WCSC believes that the CTA should prevent railway companies from using their market power to contractually require shippers to shoulder the full cost of third party liability claims.

Reasonableness of Tariffs

Subsection 67.2(1) of the CTA allows “any person” to file a complaint that a domestic air carrier has applied terms or conditions of carriage that are “unreasonable or unduly discriminatory” and allows the Agency to suspend or disallow those terms or conditions and substitute other terms or conditions in their place. In relation to air carriers providing international service, the Agency may, on its own motion, suspend or disallow unreasonable or unduly discriminatory tariff provisions. However, with respect to rail carriers, section 120.1 of the CTA:

- only allows “a *shipper* who is subject to any charges and associated terms and conditions for the movement of traffic or for the provision of incidental services that are found in a tariff that applies to more than one shipper” to file a complaint and does not permit the Agency to act on its own initiative;
- has been interpreted by the Agency not to apply to terms and conditions that are not directly related to “charges”, such as unreasonable liability and indemnity provisions;
- imposes a series of mandatory factors the Agency must consider (including, for example “industry practice”, suggesting that terms and conditions used by several carriers should not be determined to be unreasonable); and
- explicitly requires any relief from unreasonable tariff provisions to be of limited duration.

Section 120.1 is unnecessarily restrictive. The process for challenging the practices and tariffs of air carriers should also apply to those who wish to challenge the tariffs of rail carriers.

The *National Energy Board Act* gives the NEB a wider ability to disallow any tariff or portion thereof that it considers to be contrary to any provisions of the NEB Act or to any order of the NEB Board. As well, a company shall not make any unjust discrimination in tolls, service or facilities against any person or locality, and the burden of proving that the discrimination is not unjust lies on the company. We believe that legislation with respect to transportation should be consistent, therefore section 120.1 should be amended as discussed above.

Conclusion

Western Canadian resource-based commodity shippers need effective railway competition. There should be no further delay in removing the significant protection granted to the Canadian railways under the CTA. WCSC members are not protected in their domestic and international markets where vibrant competition exists. They are entitled to expect the same vibrant competition from rail service providers and, in some cases, their survival may depend on it.

**Presentation to the
Canada Transportation Act Review Panel
Submitted by the Western Canadian Shippers' Coalition
December 2014**

WCSC recommends that the CTA be amended in the following areas:

1. The interswitching limit of 160 km should be made the statutory limit applicable to all shippers in Western Canada in order to facilitate greater opportunities for intra-modal railway competition.
2. The FOA process should be made more efficient, transparent and accessible by:
 - a. removing the mandatory consideration of alternative means of transport;
 - b. providing the arbitrator with information regarding the cost to the railway of providing the service; and
 - c. giving shippers the option to have the arbitrator's decision apply for up to three years.
3. The level of service provisions should be strengthened to clarify that a railway company must fulfil its service obligations in a manner that meets the shipper's rail transportation requirements to ensure adequate capacity and service. Aggregated rail service metrics should be made available not only for the transportation of grain but for all traffic, to facilitate the efficient operation of the supply chain as a whole.
4. Railways should be prevented from using their market power to impose contractual terms that bar access to the basic shipper protections in the CTA or that require shippers to shoulder the full costs of third party liability claims.
5. The current restrictions on the Agency's mandate to examine railway tariff provisions under s. 120.1 should be removed, so that "any person" may file a complaint and so that the Agency may act on its own initiative in respect of unreasonable or unduly discriminatory terms or conditions.

WCSC is convinced that the implementation of its recommendations will improve competition in the rail sector and mitigate the railways' market power, thereby giving shippers the opportunity to negotiate rate and service agreements with railways on a fairer and more equitable basis. We ask the Advisory Panel to adopt these recommendations and recommend to the Minister of Transport that they be implemented as soon as possible. WCSC looks forward to further discussions on the contents of this document with both the appointed Chair and Members of the Advisory Panel of the CTA Review as well as with various departments within the Federal Government.



David Montpetit, Chairman
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