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May 12, 2023

The Honourable Omar Alghabra, P.C., M.P.
Minister of Transport
330 Sparks Street
Ottawa, Ontario K1A 0N5

Re: REGULATED INTERSWITCHING AND LONG HAUL INTERSWITCHING

Dear Minister:

The Forest Products Association of Canada ("FPAC") and the Western Canadian Shippers' Coalition ("WCSC") represent companies that depend on rail transportation and frequently are captive to a single rail carrier to get their products to market and to receive necessary inputs for their operations. On behalf of our members, we regularly engage with government and participate in consultations to call attention to the need for more competitive rail freight rates and service levels.

Given that the Long Haul Interswitching remedy is not useful to shippers, and that the final offer arbitration mechanism has been severely weakened, and in any event is not available to many shippers, we are focusing our attention at this time to regulated interswitching. As a remedy capable of creating a measure of competition where none would otherwise exist, regulated interswitching is an important mechanism for furthering the policy objectives of the *Canada Transportation Act.* It has proven to be a successful remedy for some shippers to get their products to market, and to benefit their communities, industries and the tax base. On its own and in its current limited form, however, regulated interswitching is insufficient to address uncompetitive rail rates and service levels even for those shippers who may be able to use it for some of their traffic.

The National Supply Chain Task Force (the "Task Force") recommended as follows:

> *Expand the 30 km interswitch distance across Canada to give shippers more rail options and to address shipper—railway power balance issues. The switch zone rates should be mileage-based and set annually by the Canadian Transportation Agency ("**CTA**"). The CTA should also monitor and review the effectiveness of this change.*

Division 22, Part 4, of Bill C-47 proposes to extend the regulated interswitching distance to 160 kilometres in the Prairie Provinces for a trial period of 18 months. Bill C-47 fails to address the Task Force's finding that

> *"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."*

FPAC and WCSC strongly recommend that the Government extend regulated interswitching to include two additional radial distance zones, without geographic discrimination, including a zone of 160 kilometres, and another of 1200 kilometres.

Our members rely on regulated interswitching outside of the Prairie Provinces. The Task Force did not recommend a geographic limit or a distance limit. We are very concerned by the limitations in Division 22, which will discriminate in favour of some shippers and shipments over others. Annex 1 illustrates the locations of just some of our members' facilities that are outside the proposed 160 kilometre radial distance in the Prairie Provinces, or outside the 30 kilometre limit in other Provinces, from the nearest interchange with another rail carrier.

In 2017, the Government allowed a provision similar to what is now being proposed in Bill C-47 to expire and came up with the new remedy called Long Haul Interswitching ("LHI"). In 2018, the Government passed Bill C-49 (the *Transportation Modernization Act*) that, among other things, introduced LHI for shippers captive to one railway. Then Minister of Transport, Marc Garneau, told the House Standing Committee on Transport, Infrastructure and Communities at the time:

> *"Our government decided the time had come to address this [regulated interswitching] with a long-term solution that would fix problems".*

He continued*:*

> *"[T]hat job was not done by the previous government. We decided to undertake it, after massive amounts of consultation."*

However, the shippers and experts who testified on Bill C-49 before the House Standing Committee and the Senate Committee on Transportation and Communications advised both committees that LHI would not work. As of this year, LHI, which was supposed to be the "long term solution," has never been used. LHI has proven to be an unmitigated failure. Unfortunately, the current budget Bill C-47, Division 22, Part 4, not only maintains the unused LHI "solution" but does nothing to address the absence of normal market forces our members face.

Moreover, regulated interswitching at a distance of 160 kilometres in the Prairie Provinces has already been tried. There is no longer any reason to limit it geographically, nor to limit the distance so much that shippers who would benefit from regulated interswitching cannot have access to it. Since we already have the experience of an identical extension during the period from 2014 to 2017, as well as the experience from 2018 to the present regarding the unused LHI remedy, there is no need for further consultation and study.

The available evidence demonstrates that the dire predictions and claims the rail industry has been aggressively advancing in its attempt to maintain the status quo that is harmful to our members are completely unfounded:

a. As Transport Canada has already found, very little traffic moved under the Zone 5 interswitching distance (160km, Prairies only) in the period 2014 to 2017 before the current government repealed it. As reported in this bulletin, in 2015 less than 0.1% of total carloads and less than 0.6% of grain traffic moved under the Zone 5 rates.

b. Contrary to CN's and CP's assertions that they will lose traffic to the BNSF Railway, the Government's own Grain Monitor found that, *after* the repeal of Zone 5 in 2017, grain shipments to the United States actually *increased*:

Three-Year Average of Rail Shipments of Grain to US Destinations Per Crop Year (tonnes)		
	from Western Canada to the US	**from Western Canada to US West***
Aug 2014 - July 2017 (with regulated interswitching to 160km)	7,047,836	2,552,699
Aug 2018 - July 2020 (with regulated interswitching to 30km)	7,381,789	2,857,248

*(comprising the states of AK, AZ, CA, CO, HI, ID, MT, NM, NV, OR, UT, WA and WY)

Source: Annual Report of the Monitor - Canadian Grain handling and Transportation System - Crop Year 2021-2022

c. The Railway Association of Canada claims that extended interswitching will slow down supply chains. On the contrary, CN's and CP's respective 2019 Investor Fact Books show that through all or most of the period from 2014 through 2017, while Zone 5 interswitching was in force, system average train speeds, car velocity and yard productivity (measured in cars handled per yard switching hour) *increased* while dwell times *decreased.* Performance in all of these categories *worsened* in 2018, the first full year after the repeal of Zone 5 interswitching:

STATISTICAL HIGHLIGHTS [CP]	2014	2015	2016	2017	2018
Average terminal dwell (hours)	8.7	7.2	6.7	6.6	6.8
Average train speed (miles per hour, or "mph")	18 .0	21.4	23.5	22.6	21.5

Source: CP 2019 INVESTOR FACT BOOK, p. 1.

OPERATING METRICS [CN]	2014	2015	2016	2017	2018
Car velocity (car miles per day)	199	224	236	211	188
Yard productivity (cars per yard switching hour)	44	48	51	51	49
Through dwell (hours)	8.3	7.3	6.9	7.7	8.3
Through network train speed (miles per hour)	20.3	21.5	22.5	20.3	18.0

Source: CN 2019 Investor Fact Book, p. 21

If actual data exists to confirm any adverse effect on efficiency, capacity or reliability, it has not been made available.

d. Claims about congestion at competitive interchanges between railways ignore a fundamental reality, recognized by the Canadian Transportation Agency: a railway can dissuade shippers from availing themselves of interswitching options by making its rate and service offering more appealing than that of the competing carrier. Where rate and service offerings are equal or even slightly worse, a shipper will prefer the more efficient and direct routing for its traffic, and avoid routes susceptible to congestion if possible.

e. As it regularly does when the Government consults on any initiatives that could reduce the market power imbalance between shippers and rail carriers, the railway industry alleges that expanding regulated interswitching, even on the very limited scale contemplated by Bill C-47, will be a disincentive to private investment. 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.

f. The criticism that regulated interswitching requires CN and CP to carry traffic “at cost” or “below market rates” is also misleading. Interswitching rates must be “commercially fair and reasonable to all parties.” The Agency sets regulated interswitching rates at a level that compensates the railways for the total economic cost of the service they provide. These economic costs include explicit costs such as operating costs, including the depreciation of assets, as well as the implicit costs associated with the returns on investment in those assets. In other words, the Agency assures CN and CP that they will earn their cost of capital and be able to provide ample returns to their shareholders. The regulated interswitching rates for 2023 include a contribution to railway fixed costs of *83.35% above variable costs.* In fact, both railways earn much more. Unfortunately, where regulated interswitching is not available, the local railway has complete discretion to dictate the rate at which a captive shipper can access a competing carrier. Rates set in this manner are not “market rates” produced by a normally functioning market; instead, they are monopoly rates.

g. The Government should also not be swayed by claims that rail freight rates in Canada are “among the lowest in the world” or that a recent study commissioned by the Railway Association of Canada provides evidence of “robust competition” between railways. The conclusions drawn in or on the basis of the CPCS Study entitled “International Comparison of Railway Freight Rates” are misleading in a number of respects. For example, there are significant differences between the various countries in terms of the distances over which goods are transported by rail. Much of the railway’s cost associated with a rail movement is incurred at the beginning and end, and that cost is built into the freight rate. Spreading these costs over 200 miles results in much higher rates than spreading them over 900 miles. It should come as no surprise that, on a revenue per ton-mile basis, European shorter haul rates are higher than Canadian rates, which cover a much longer distance, or that the CPCS Report shows that Russian rail freight rates – which on average cover even longer distances than average lengths of haul in Canada – are lower than rates in Canada. A similar relationship can be observed between short-haul and long-haul rates within Canada.

Consistent with the above, our members’ experience has been that the primary benefit of access to regulated interswitching, where it is available, is not that it allows for (or results in) large scale re-routing of traffic but that it introduces some measure of competitive tension into relationships that are otherwise completely unbalanced. If CN and CP are worried about losing traffic to each other or to other rail carriers, all they need to do is provide competitive rates and service. In this scenario, the Canadian firms and workers responsible for our nation’s economic prosperity and innovation can share the benefits of a reliable, efficient, and competitive freight rail system.

We strongly urge the Government to reconsider the measures contained in Bill C-47 and to extend regulated interswitching to include two additional radial distance zones, without geographic discrimination, including a zone of 160 kilometres, and another of 1200 kilometres to replace the problematic LHI remedy.

We would be pleased to meet with you or your departmental officials to discuss any questions you may have.

Sincerely,

David Montpetit
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Ben McArthur
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ANNEX 1 – Examples of FPAC and WCSC Member Facilities (non-exhaustive) outside the proposed 160 km radial distance in the Prairie Provinces or outside the 30 km radial distance in other Provinces.