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Brief

addressed to

The Senate
Standing Committee on Transport and Communications

Regarding Division 22 of Part 4
Bill C-47, the *Budget Implementation Act*

by

the Forest Products Association of Canada

and

the Western Canadian Shippers' Coalition

May 17, 2023

INTRODUCTION

Forest Products Association of Canada (FPAC) and the Western Canadian Shippers' Coalition (WCSC) are providing this joint brief to the Senate Standing Committee on Transport and Communication (TRCM) to recommend that the extended regulated interswitching provisions contained in Bill C-47, the *Budget Implementation Act, 2023, No. 1* be strengthened and expanded.

More specifically:

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, and that these additional zones not be made subject to any sunset provision.

THE CAPTIVE SHIPPER PROBLEM

In its final report, the National Supply Chain Task Force confirmed the persistence, despite previous initiatives hailed as "long term solutions," of a fundamental problem:

> *"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."*

In order to address this problem, the Task Force recommended, among other things:

> *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.*

The Task Force did not specify a distance limit for the expansion of regulated interswitching, and it explicitly recommended that expanded regulated interswitching be made available across *all* Provinces.

REGULATED INTERSWITCHING IS EFFECTIVE WHERE AVAILABLE

Regulated interswitching is an important pro-competitive remedy in the *Canada Transportation Act.* It gives some rail shippers who would otherwise have to rely on the sole rail carrier at their facility the right to negotiate with a second rail carrier and to access that carrier at commercially fair and reasonable rates set annually by the Canadian Transportation Agency (Agency).

The remedy lessens the local carrier's ability to engage in behaviour that blocks competition, such as preventing its customers from securing needed railcar supply from another railway and imposing monopoly rates to the interchange that unfairly impair the connecting railway's ability to compete for the traffic. Instead, the existence of regulated interswitching incents the local carrier to make its rate and service offering more competitive in order to keep the traffic on its own network and fosters more balanced commercial negotiations.

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.

BILL C-47 DOES NOT FIX THE PROBLEM

Bill C-47 proposes to reintroduce, on a temporary basis, a limited expansion of regulated interswitching to a distance of 160 km in the Prairie Provinces. It will not address the effects of the monopoly power CN and CP enjoy over those of our members with facilities located in other Provinces or facilities located more than 160 km away from an interchange in the Prairie Provinces. Instead, it will discriminate against them in favour of other shippers. The map provided in Annex 1 illustrates the locations of some of the facilities of our members for which Bill C-47 fails to provide any relief.

In 2017, the Government allowed a provision similar to what is now being proposed in Bill C-47 to expire and came up with a new untried remedy called Long Haul Interswitching ("LHI") to apply over distances of up to 1200 kilometres. 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 also no need for further study. By restricting the availability of expanded interswitching limits to a narrow window of eighteen months, Bill C-47 further reduces the number of shippers who may benefit from the measure, excluding in particular those shippers who have multi-year transportation contracts and will not be entering any new negotiations until after the proposed pilot program expires.

THE RAIL INDUSTRY'S DIRE PREDICTIONS ARE UNFOUNDED

The rail industry has advanced sweeping claims in an effort to avoid any erosion of the imbalance in market power it enjoys under the status quo to oppose, even through the limited expansion of regulated interswitching proposed in Bill C-47. The dire predictions advanced by Canadian National Railway Company (CN), Canadian Pacific Railway Company (CP) and their industry association (RAC) are entirely unfounded and unsupported by credible evidence:

a. As Transport Canada has already found, very little traffic moved under the Zone 5 interswitching distance (160km, Prairies only) in the period from 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

Similarly, CN's and CP's detailed traffic data submissions to the Agency for the purposes of the Maximum Revenue Entitlement for the Movement of Grain, confirm that the previous expansion of regulated interswitching did *not* coincide with a reduction in the volumes of grain transported by CN and CP to Canadian ports or processing facilities in Canada:

Western Grain Movements* by Crop Year (tonnes)					
Interswitching Limit	**30 km**	**160 km**			**30 km**
Crop Year	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
CN	19,209,590	20,347,455	19,784,579	22,322,614	20,983,547
CP	19,252,363	20,958,736	20,608,823	20,874,001	19,634,738
Total	**38,461,953**	**41,306,191**	**40,393,402**	**43,196,615**	**40,618,285**

*includes grain grown in the Western Division (or grown outside Canada and imported into Canada) and moved to Thunder Bay, to Churchill or ports in British Columbia for export, or to processing facilities in Canada; *excludes grain shipped by rail to the United States*

Source: Canadian Transportation Agency, annual determinations of Maximum Revenue Entitlement

c. On a more general level, there has always been – and will likely always be – an imbalance in rail movements between Canada and the United States. Historically, southbound rail volumes have consistently been more than twice as high as northbound rail volumes.[1] South of the international boundary *all* Class 1 rail carriers (including CN's U.S. Subsidiary and CP's U.S. Subsidiary) use U.S. employees to dispatch and crew their trains and to perform track maintenance and switching in rail yards. The suggestion that any expansion of regulated interswitching must exclude U.S. based rail carriers in order to preserve *Canadian* jobs is misleading. Finally, when the United States Surface Transportation Board proposed certain rule changes that would have created a US version of regulated interswitching (i.e., created the "reciprocity" CN and CP claim they want), both of them vociferously opposed that initiative. Then as now, they are more concerned with *preventing* competition than in reciprocity.

d. RAC 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:

[1] See Statistics Canada. Table 23-10-0062-01 – Rail industry origin and destination of transported commodities.

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.

e. 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.

f. 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.

g. 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 CN and CP 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 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 because of a normally functioning market; instead, they are monopoly rates.

h. To the extent that CN and CP reduced their respective employee headcount during the previous period of expanded interswitching, the notion that these reductions were occasioned in whole or in part by the loss of traffic to U.S. carriers is unsupported by any actual evidence. Other factors provide a far more plausible explanation, including the following:

- In addition to the efficiency achievements outlined in paragraph c above, from 2014 to 2016, CN and CP increased their respective average train productivity and train length, all contributing to reduced crew requirements.

- Grain production in Alberta and Manitoba, the only Prairie Provinces with interchanges to U.S. carriers, was more than 15% lower in 2014 and 2015 than in 2013, the year before 160km interswitching.[2] At the same time, the total volumes of Western grain (i.e., grain grown west of Thunder Bay) moved by CN and CP to Canadian ports were higher in every crop year from 2014 to 2017 than during the 2013-14 crop year.[3]

- From 2014 to 2016, *all* Class 1 rail carriers across North America saw a reduction in revenue-ton-miles, a common industry measure of workload.[4]

i. Parliament 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 evidences "robust competition" between railways. The conclusions drawn in or based on 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. As noted in the 2001 report ("**Vision and Balance**") of the *Canada Transportation Act* Review Panel "…because of rate taper, revenue per tonne-kilometre would be lower for longer movements than for shorter ones." The panel continued:

> 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

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

[3] Source: Canadian Transportation Agency, annual determinations of Maximum Revenue Entitlement.

[4] Source: CN 2019 Investor Fact Book, p. 27; BNSF Railroad Annual Reports (2014-2016) to the United States Surface Transportation Board.

> 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.[5]

> It should come as no surprise that, on a revenue per ton-mile basis, European shorter haul rates are higher than Canadian rates for much longer average hauls, or that Russian rail freight rates – which cover distances even greater than the average length 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.

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.

RECOMMENDATION:

FPAC and WCSC strongly recommend that Division 22 in Part 4 of Bill C-47 be amended by providing for the creation of two additional radial distance zones, without geographic discrimination and without any sunset provision, including a zone to a distance of 160 kilometres and a further zone to 1200 kilometres to replace the unused LHI remedy.

ABOUT FPAC

FPAC provides a voice for Canada's wood, pulp and paper, and forest bioproducts producers nationally and internationally in government, trade, and environmental affairs. Canada's forest products industry generates some $72 billion dollars in revenues annually, operating in hundreds of forest-dependent communities and directly employing more than 205,000 Canadians across the country. Canadian forest products manufacturers exported more than $45 billion worth of goods to the global market in 2022, representing roughly 6% of all Canadian exports. Our sector is also one of the largest employers of Indigenous peoples in Canada and includes some 1,400 Indigenous-owned businesses.

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[5] See *Vision and Balance,* Report of the *Canada Transportation Act* Review Panel, June 2001 (https://publications.gc.ca/collections/Collection/T22-107-2001E.pdf), page 68 and footnote 5 on page 98.

The forest products sector is one of the largest users of the Canadian rail system, transporting over 26 million tonnes by rail annually. 88% of rail-served FPAC member facilities are captive to one railway, with the next competing railway hundreds of kilometres away.

ABOUT WCSC

Western Canadian Shippers' Coalition (WCSC) is the voice for western shippers for whom a safe, efficient, environmentally sustainable and cost effective transportation function is vital to their success. WCSC membership is comprised of a unique, multi-commodity group of shippers:

- aggregate, asphalt, cement, concrete, fly ash
- coal
- copper
- energy
- forestry
- industrial minerals
- marine fuel
- oilfield services
- potash
- renewable energy
- sulphur
- zinc

WCSC membership includes some of the largest Canadian and North American shippers in these sectors. Collectively, members provide tens of thousands of direct and indirect jobs in communities across Canada, ship billions of dollars' worth of product annually, and spend more than $3.5 billion on total transportation costs. A key point of commonality for our members is a reliance on market-dominant providers of rail transportation.

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.