

Strategic Directions
The Canada Transportation Act Review 2014
Recommendations from the CTA Review Coalition

Executive Summary

The Agriculture Industry CTA review coalition is grateful for this opportunity to contribute to the Canada Transportation Act review process. The coalition represents a wide variety of agriculture industry stakeholders including shippers, processors and producers. Improving Canada's transportation system will be critical to the future growth and prosperity of the Agriculture industry and recent years have demonstrated that change is urgently required. Agriculture industry stakeholders have become increasingly frustrated by the evolution of the Canadian railway system in recent decades which has seen railway efficiency as measured by rail operating ratios and income steadily improve while service has not been adequate to meet shippers' needs in an increasingly competitive global marketplace.

This proposal was developed through extensive consultation with coalition members and with the support of two of Canada's most experienced legal experts in rail regulation and operations.¹

Problems with the Canadian rail freight system

The coalition believes that there are three fundamental problems with the Canadian railway industry. They are: a lack of railway capacity due to underinvestment, poor performance due to a lack of competitive pressure, and inadequate shipper protection measures in the Canada Transportation Act.

From the beginning of 2000 to the end of 2012, railway workload increased by 34% but over that same period railway net capital investment was negative for 10 of the 13 years of that period. However railway operating income measured in constant 2007 dollars increased by 46% to \$4.25 billion in those years and it grew an additional 13% in 2013 to \$4.8 billion.²

Over that same period, as was demonstrated through the quantitative analysis and stakeholder submissions to the Rail Freight Service Review in 2008-2010, inadequate rail service did not meet shippers' needs to grow and remain competitive. Recently, the performance measurement initiative of the Ag Transport Coalition has been established to clearly measure railway performance and their findings confirm that railway service remains below levels required to support a growing Canadian economy.³ A recent survey of North American rail shippers conducted for RBC Capital Markets found that 66% of CN shippers and 79% of CP shippers rated the railways service offering as "Poor" or "Fair".⁴

Canada's railways have significant market power over their customers and this economic dominance is particularly strong in the Agriculture sector where shippers have very limited options to transport their products other than by rail. National Transportation Policy as expressed in Section 5 of the Canada

¹ The brief biographies of Mr. Forrest Hume and Mr. Ian MacKay are attached as an appendix to this paper.

² See Section 2.1, "Railway capacity".

³ See Section 2.2, "Railway performance".

⁴ RBC Capital Markets North American Railroad Shipper Survey, December 2014.

Transportation Act recognizes that regulation and strategic public intervention must be used when satisfactory outcomes cannot be achieved by market forces alone. However, the shipper protection measures in the Act do not work effectively to rebalance the commercial relationship between shippers and railways in order to achieve outcomes that allow shippers to meet their commercial need for efficient rail service.

The current regulatory regime is one where there is an imbalance of access to information between the railways and both the regulators (the Canadian Transportation Agency and Transport Canada) and shippers. This imbalance of information hobbles the regulators in their role and shippers in their commercial relationships with railways.

In addition, the Act severely limits the Agency's ability to investigate and address systemic problems in the rail system. Shippers who decide to use the regulatory remedies in the Act face long and expensive processes that sometimes fail to resolve the underlying problems.. Most importantly, it is the shipper, subject to the dominant market power of railways, who must initiate any Agency investigation or arbitration and this fact leaves them vulnerable to a very real threat of retaliation from their railway supplier.

As the root cause of the problems in the railway system is an imbalance of market power between shippers and railways, the solutions proposed by the coalition are designed to off-set railway power to ensure that railways respond to shippers needs in ways that simulate the operation of a market driven system.

Recommendations

The coalition's advisors considered over 30 distinct proposals for change and developed 10 specific recommendations in five areas.

1. Powers and effectiveness of the Agency

- Restore the Agency's power to act on its own motion and to issue temporary ex parte orders.
- Improve the Agency's sources of information about the rail freight system through:
 - enhanced railway reporting to the Agency on commercial and operational activities and enhanced Agency reporting to stakeholders on railway revenues and costs.
 - development of a process of independent, detailed and timely monitoring of railway performance overseen by an advisory body made up of rail system users.
 - provision of the authority and resources for the Agency to engage on an on-going basis with stakeholders.

These recommendations will increase the effectiveness of the regulator by providing a stronger regulatory backstop for shippers and a deterrent for railways to abuse their market power. By doing so it will support shippers in their day to day commercial and operational relationships with railways.

2. Railway service obligations

- Align level of service provisions of the Act with National Transportation Policy to stress that the needs of the users of the system are paramount.
- Provide for financial consequences for non-performance in service level agreements and in Agency decisions on service level complaints.

These changes will ensure that day to day commercial negotiations between railways and shippers are based upon the requirement that railways provide service that meets the needs of the users of the system and promotes competitiveness and economic growth – as outlined in National Transportation Policy. These changes will also ensure that there are real consequences for railways if they fail to meet standards set out in service level agreements or Agency decisions made pursuant to an investigation into railway service.

3. Shipper protection measures

- Make the use of threats and intimidation by railway employees punishable by fines.
- Amend Section 120.1 of the Act to allow review of all freight tariff charges and conditions (other than a rate for the movement of traffic) by the CTA, upon application by the shipper.
- Make improvements to service level arbitration
 - Remove the requirement for an arbitrator to consider a railway's service obligations to other shippers to ensure railway is not given an unfair advantage through their privileged access to information.
 - Make the definition of operational terms published pursuant to the Fair Rail for Grain Farmers Act permanent, and amend the working of the regulations to remove from the list of items subject to a force majeure condition, those factors which are within a railways reasonable control.

The use of threats or intimidation by a railway as a supplier of transportation services with common carriage obligations in its dealings with shippers is unacceptable. In addition, these changes are designed to improve the effectiveness of two current shipper protection measures by broadening the Agency's scope of investigation of rail freight tariff terms and conditions and ensuring that railways are not excused from delivering service under a service level agreement by factors that are within railway control.

4. Pro-competitive measures

- Amend section 138 of the Act to allow the Agency to grant running rights to a shipper or railway company without requiring as a precondition of relief, proof of a rate or service failure by the host railway
- Make permanent the changes that extended the interswitching zones to 160 km for the Prairie Provinces.

Running rights and interswitching are two of the areas where regulators can ensure that there is a measure of direct competition between rail carriers by regulating access to their networks and – in the case of running rights – providing for entry by new competitors to stimulate competitive pressure on rail carriers.

5. Measures particular to the Grain Industry

- Add chickpeas and soybeans to Schedule 2 of the Act to bring these crops under the definition of regulated grains.
- Maintain the maximum grain revenue entitlement without change.

It is important that the list of regulated grains be modernized to reflect current production patterns on the Canadian Prairies. Recent railway underinvestment in grain handling capacity is symptomatic of their market dominance not just in the agricultural sector but in all sectors. Removing the rate protection afforded to the agricultural sector will not create any incentive for railways to increase investment in this sector and it will simply result in a further transfer of wealth from the Agriculture sector to railway shareholders.

All of the recommendations of the coalition are designed to improve the competitiveness of the rail freight industry by providing for an enhanced regulatory backstop for shippers in their day to day commercial and operational dealings with railways. With these improvements, shippers and railways will be induced to seek continued efficiency of the system while ensuring that rail service supports the growth and international competitiveness of Canada's rail freight supply chains.